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The Honorable Vernon A. Williams
Secretary
The Surface Transportation Board
1925 K Street, N.W.
Washington, D.C. 20423-0001

Re: <u>Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures</u>

Dear Secretary Williams:

Enclosed for filing in the above-captioned proceeding are the original and twenty-five (25) copies of the Rebuttal Comments of The Burlington Northern and Santa Fe Railway Company, including the rebuttal verified statements of Professors José A. Gómez-Ibáñez and Joseph P. Kalt, and Professor Richard J. Pierce, Jr. Also enclosed is a 3.5 inch disk, containing the text of the Comments in WordPerfect 9 format.

I would appreciate it if you would date-stamp the enclosed extra copy of the Comments and return it to the messenger for our files.

Sincerely,

Erika Z. Jones

Erika Z. Jones

Enclosures

cc: All Parties of Record

201280

BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS OF THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

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January 11, 2001

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EX PARTE NO. 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

REBUTTAL COMMENTS OF THE BURLINGTON NORTHERN AND SANTA FE RAILWAY COMPANY

The Burlington Northern and Santa Fe Railway Company ("BNSF") hereby files its rebuttal comments on the Notice of Proposed Rulemaking ("NPR") issued by the Surface Transportation Board ("Board" or "STB") on October 3, 2000, in Ex Parte No. 582 (Sub-No. 1).

BNSF continues strongly to believe that sound merger policy must recognize that the public has an abiding interest in an increasingly efficient and dynamic rail network. Service is the key to the performance of that network, and BNSF fully supports those aspects of the Board's proposed rules that are designed to ensure that no service degradation will result from future mergers. Furthermore, shippers are right when they say that railroad mergers should not result in increased market power – competition-*preserving* conditions on railroad mergers have been appropriate in the past and will be appropriate in the future. But quality service requires enormous capital investment to renew and improve the rail system in this country. Service assurance plans, while certainly beneficial, cannot substitute for essential financial incentives to invest in the infrastructure, equipment, and technology necessary to provide the service demanded by shippers. And these are investments the industry must make and justify every day, independent of any rail merger or "alliance" plans.

Whether that investment will be made depends in significant part on whether the Board adopts and applies a merger policy and procedures that encourage investors to continue risking their money in this industry. Investors have choices. If a business does not hold out the prospect of providing a reasonable return over the long term, investors will take their money elsewhere. Adoption of key elements of the NPR, both in their proposed direct effects on future mergers and their potential implications for the entire rail industry, would send a strong signal to investors that the risks of future investment will increase.

The Board should not turn its back on the successful policies of the past. Under the deregulatory regime sparked by the Staggers Rail Act of 1980, railroad management and the investment community have been encouraged to invest enormous amounts of capital into the nation's rail system. The productivity improvements and increased competitiveness of the industry resulting from these investments have validated the reliance Congress, the Board, and the public placed on marketplace incentives to avoid the financial collapse of the industry. The industry has made a financial comeback at the same time that railroads' rates to shippers have dropped on average by over 50% in real terms since 1982.

Furthermore, recent mergers have contributed to that trend. Despite many shippers' unsupported claims in this proceeding, the actual data show – as the Board's staff recently concluded – that recent mergers have *not* increased railroad market power, but instead have resulted in even lower rates to shippers.

The promise of mergers to contribute *both* to shipper well-being and the industry's financial comeback is far from exhausted. The railroads have yet to earn the returns that will permit them even to sustain the existing rail system over the long term, let alone expand their capacity to handle the additional traffic that improved service is generating. The Board correctly perceives that the opportunities for the railroads to improve their financial performance through the elimination of redundant capacity are largely past. The Board is wrong, however, when it suggests in the NPR that the kinds of end-to-end mergers that are likely in the future do not hold out the promise of significant efficiencies that can improve both the railroads' financial performance and their service to shippers. Many of the commenting parties are also wrong when they suggest that the Board's current standards and tools for assessing the competitive effects of a proposed merger are inadequate and biased against competition. Mergers remain one of the most effective ways that railroads can reduce their costs, expand available capacity, improve and streamline their service, and enhance competition for a large number of rail shippers. A proper use of the Board's conditioning power can ensure that they have no anticompetitive effects. The proposals that have been made for an unprecedented mandated "competitive enhancement" approach to merger review threaten to choke the process with unwarranted and opportunistic grabs for special conditions that could kill procompetitive and financially beneficial mergers.

None of this is lost on railroad shareholders and potential new investors. The length of the rail merger review process itself is a significant deterrent to undertaking the risk of a merger. In most industries, far larger mergers than those in the rail industry are regularly reviewed by the government in a matter of months, not years. Investors are well aware that markets do not stand still while rail merger proposals are pending, and management decisions by the merging railroads about how best to allocate their investments and assets are held in limbo while the Board deliberates. The longer and more vague and uncertain the process, the more deleterious the effects. The uncertainty would only be compounded by concerns that mandated "competitive enhancements" could so diminish the benefits of the transaction, if it is approved, that it would be uneconomic.

Railroad management cannot ignore such deterrents to initiating a merger proposal. If investors cannot be assured of a predictable framework for review and an expeditious outcome, they will punish the proponents of the proposal. And if the railroad cannot find other ways to cover the costs of maintaining and improving its existing system, it will be forced to reduce its investment and retrench to a system or a set of services that can cover their costs. This is not theory, but hard reality, and no commenter seriously questioned these facts. In the wake of the merger moratorium, BNSF itself has had to reconsider many of the capital projects it had planned for its system. If the long-term growth prospects of the nation's rail system are constrained by an uncertain and lengthy merger approval process, the value of continued investment in that system will likewise be constrained. At this critical juncture in the industry's effort to expand its capacity to provide better service to its customers, such a misguided merger policy is the last thing the country needs.

Having already comprehensively addressed multiple features of the NPR and of other commenters' proposals in its initial and reply comments, BNSF will confine these rebuttal comments to seven general themes, each responsive to attacks on BNSF's initial comments:

1. An expedited schedule for the resolution of Class I merger applications is realistic, appropriate, and necessary.

2. Past mergers have not harmed competition – indeed, they have generated significant public benefits and enhanced competition – and future mergers can be expected to do likewise.

3. The Board's merger policy should not favor alliances over mergers.

4. Mandated open access should not be pursued through merger conditions.

5. The scope of post-merger oversight should be limited to the efficacy of conditions imposed to maintain competitive options for shippers and the remedy of any merger-related service problems.

6. Railroads do not enjoy a privileged position of immunity from the antitrust laws, and application of antitrust principles to railroad mergers would require rejection of many of the shippers' major arguments.

7. The pro-merger and deregulatory policies of the ICCTA limit the Board's authority to adopt many of the proposed regulations.

In support of BNSF's rebuttal comments, attached are the joint Rebuttal Verified Statement of Jose Gómez-Ibáñez and Joseph P. Kalt ("V.S. Gómez-Ibáñez/Kalt") and the Rebuttal Verified Statement of Richard J. Pierce, Jr., ("V.S. Pierce").

I. AN EXPEDITED SCHEDULE IS REALISTIC, APPROPRIATE, AND NECESSARY

In Attachment 1 to its initial comments, BNSF set forth a schedule that would result in final Board action on a Class I merger application within one year of the pre-filing notice. BNSF suggested that the Board's procedures should more closely emulate those of the federal antitrust authorities and the Federal Energy Regulatory Commission ("FERC"), among others.[1] In particular, the Board should in most cases rely primarily on clearly defined filing requirements and, when appropriate, on information requests from its staff, rather than its current extended discovery process.[2] In its initial and reply comments, BNSF demonstrated that expedition is necessary to meet the requirements of capital markets and to prevent the proposed merger partners from being subject to extended periods of uncertainty.[3]

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1 *See* BNSF Rebuttal Comments, Attachment 1 (compiling data on FERC electric mergers from the chart on FERC's web site, http://www.ferc.fed.us). Attachment 1 also contains a synopsis of each merger's relevant procedural history, including information on whether the applications were protested.

2 BNSF Initial Comments at 19-20, & n.13.

3 *Id.* at § III (A); BNSF Reply Comments at § II (A), (B).

BNSF's proposal was attacked by several parties on varying grounds.[4] Significantly, however, none of the arguments even attempted to refute BNSF's basic premise that the rail industry is disadvantaged in the capital markets because the federal review of Class I rail mergers takes much longer than federal review of mergers in other industries. Nor did any party attack or refute BNSF's premise that the attraction and retention of private capital are essential to the development of the high quality services and supply chain capabilities that shippers, as well as other links in the surface transportation network such as short lines, regional railroads, and ports, require.

Edison Electric Institute ("EEI"), joined by other parties, argued that the Board could not process merger applications as quickly as FERC and the antitrust agencies.[5] EEI's arguments are flawed in several fundamental respects. First, EEI argued that any future Class I mergers will be larger than most mergers considered by FERC.[6] But the complexity of merger review properly rests on the complexity of the competitive issues raised by a specific merger, not the size of the merging parties.[7] As demonstrated by Attachment 2

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4 *See, e.g.,* Amtrak Reply Comments at 8-9; Committee to Improve American Coal Transportation ("IMPACT") Reply Comments at § B(7); PPL Generation, LLC and PPL Montana, LLC ("PPL") Reply Comments at §§ II and III; EEI Reply Comments at 2-3, 5-6, 12-13; United States Department of Agriculture ("USDA") Reply Comments at 9-10.

5 EEI Reply Comments at § II; *see also* Amtrak Reply Comments at 8-9; PPL Reply Comments at § II.

6 *Id.* at 7 & n.5 (objecting to an expedited review for large transcontinental mergers but not for "relatively minor transactions" such as a merger between two short line railroads).

7 BNSF Rebuttal Comments, V.S. Pierce at 4.

to BNSF's initial comments, many mergers that are far larger than any conceivable combination of Class I railroads have been processed in a matter of months.[8] Further, they are processed expeditiously even though approvals are often required by multiple agencies.[9]

Second, EEI argued that FERC could expedite its review of merger proceedings because FERC has clearly defined the issues it will consider in any merger proceeding,

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[8] For example, in 1998, British Petroleum and Amoco received approval for their $55 billion merger from both the Federal Trade Commission ("FTC") and from European authorities in 4½ months; BankAmerica and NationsBank completed a $45 billion merger in 5½ months after expedited review by the Department of Justice ("DOJ") and the Federal Reserve Board; and MCI and WorldCom received final merger approval for their $44 billion transaction from the Federal Communications Commission ("FCC"), the FTC, and European authorities in under 11 months.

It should be noted that commenters to the NPR have themselves taken advantage of expedited review for their multi-billion dollar mergers. In 1997, Enron Corporation received merger approval for its $3 billion merger with Portland General Corp. in less than one year. "The FERC has applied its merger guidelines quickly and pragmatically while protecting the public interest in this pro-competitive merger decision," noted Kenneth L. Lay, Enron Chairman & CEO, in a Feb. 26, 1997 press release.

Furthermore, when commenter Procter & Gamble ("P&G"), the world's largest sanitary napkin producer, merged with Tambrands, Inc., the world's largest tampon producer, merger approval took less than 4 months, despite the $1.8 billion transaction value. "Company executives said they did not expect the deal to face regulatory opposition because tampons and pads were distinct markets with little cross-over." P&G News Release, May 8, 1997. In neither of these cases was the size of the merger the determinative factor in their receiving expedited regulatory review.

[9] EEI suggests that FERC's processes are faster because "many other agencies must approve utility mergers" and thus FERC's role is more limited. Rebuttal Verified Statement of Edward H. Comer ("V.S. Comer") at 9. Even assuming this were true, it would not be relevant. If mergers involving multiple agencies can still be completed expeditiously, that obviously does not supply a reason why the STB needs more time.

including any remedies for identified competitive issues.[10] This argument supports BNSF's position in favor of expedition, because the final rules adopted in this proceeding, coupled with the STB's existing policies, will provide similar definition. For example, any future Class I merger applicants already know that they must propose to remedy any "2-to-1" situations their merger would create. The final rules issued as a result of this proceeding will provide additional guidance, for example, with respect to major open gateways. These are the Board's counterparts to the FERC policy designed to "be sure that the merger applicants had mitigated market power" that otherwise would arise from the merger.[11]

Third, EEI argued that FERC is able to expedite its processing of merger applications because many merger applications now involve so-called convergence mergers, in which an electric utility and a natural gas pipeline or distribution company propose to merge.[12] This argument also supports BNSF's position. As discussed in Professor Pierce's rebuttal statement, the end-to-end rail mergers that may be proposed in the future are more akin to convergence mergers than the rail mergers of the past that

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10 *Id.* at 2-4.

11 *Id.* at 4.

12 *Id.* at 8. Mr. Comer concludes that "these merger[s] are analogous to a merger between a Class I railroad and a non-rail transportation provider operating in a different part of the country, [and] not a merger between two Class I railroads." *Id.* But this conclusory statement is the full extent of his analysis. Mr. Comer nowhere explains his rationale for rejecting an analogy between FERC convergence mergers and end-to-end rail mergers.

involved significant horizontal elements.[13] Thus, by EEI's own analogy, the STB should commit to an expedited schedule *at least* for end-to-end rail mergers, which are analogous to convergence mergers. And, in the event that a rail merger application is filed that presents substantial overlap or other significant competitive issues, the STB can determine that an expedited schedule is inappropriate for that particular case, just as FERC does when it confronts a merger application that presents significant competitive issues.[14]

EEI's witness, Mr. Comer, also attacked BNSF's comparison to the FERC process as "misleading," because BNSF omitted "significant" aspects of FERC's merger policy –

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13 "[C]onvergence mergers have a close analog in the railroad context. End-to-end rail mergers are very similar to convergence mergers. Neither class of proposed mergers raises serious anticompetitive concerns because neither involves a proposal to merge firms that compete with each other." BNSF Rebuttal Comments, V.S. Pierce at 6.

14 EEI also challenged BNSF's analogy to FERC's experience processing utility mergers by asserting that "[m]any of the mergers included in the average [processing time for FERC review of utility mergers] raised few if any competitive or other significant issues and were approved quickly." EEI Reply Comments at 6. EEI is correct that the average includes utility mergers that raised "few if any competitive" issues – but the same is likely to be true of most of the remaining potential rail mergers. Indeed, the STB has confronted "few if any competitive" issues in recent rail merger applications because the applicants have understood that they have an obligation to identify suitable replacements for lost competition under the Board's precedents.

In fact, a review of recent FERC merger proceedings shows that, of 57 proceedings, only eight took longer than the approximately one year time frame proposed by BNSF for rail mergers. And, after FERC adopted its new merger guidelines in December, 1996, only three merger applications have taken more than one year to process – and those proposals appeared to present significant *competitive* issues. Absent serious *competitive* issues, FERC has not set an application for formal hearing or allowed third-party discovery. EEI has not identified a single recent FERC merger proceeding that took longer than one year and that did *not* raise significant competitive issues. And, as explained above, future rail merger proceedings are unlikely to raise serious, unremediable competitive problems.

notably FERC's open access policy and its post-merger rate protection policy.[15] BNSF responds to Mr. Comer's open access assertion in Part IV below. Suffice it to say here that FERC has expressly determined that selectively applying open access requirements in individual merger proceedings was *not* good policy. As to FERC's rate protection policy, it has no possible counterpart in modern rail regulation, because most rail rates are not regulated. As Professor Pierce explains in his rebuttal statement, the rate protection measures proposed most frequently in mergers reviewed by FERC "apply only to the rates charged by electric utilities to perform functions that remain subject to pervasive cost-of-service regulation in order to protect consumers from potential exercises of natural monopoly power."[16] The framework of STB regulation of the railroads is not comparable, and the absence of maximum "rate protection measures" in STB merger proceedings can have no reasonable bearing on the time needed to process rail mergers.[17]

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15 EEI Reply Comments, V.S. Comer at 2-6.

16 BNSF Rebuttal Comments, V.S. Pierce at 9.

17 The STB does, in fact, ensure customer protection from merger-related harms under its current policy of requiring merger applicants to develop remedies for all shippers who were served by two rail carriers before the merger, but who would otherwise lose that competition. This policy, which has the effect of requiring the applicants to grant access to another carrier, is well settled and not proposed to be changed in the new merger rules. Further, the result of this rulemaking should be additional guidelines, such as service and open gateway requirements, that will guide the applicants and other participants in merger proceedings.

It bears noting as well that no shipper has adduced any evidence in this proceeding to demonstrate that rail mergers have resulted in rate increases. As discussed in Part II below, all the evidence is in fact to the contrary. Thus, Mr. Comer's FERC rate protection point appears to be a remedy in search of a problem that does not exist in the rail industry.

Fourth, EEI opposed BNSF's proposal that the Board's traditional trial-type discovery procedures be replaced in most cases by the staff-directed informal discovery used by the Department of Justice ("DOJ"), the Federal Trade Commission ("FTC"), and, in most cases, FERC.[18] However, EEI did not offer any reason why trial-type discovery is necessary or why it adds public benefits that outweigh the significant costs imposed by the delays attendant to the discovery process. EEI also did not explain why DOJ, FTC, and FERC can process mergers without trial-type discovery but the STB cannot. BNSF believes that EEI and its members would strongly oppose any suggestion by any of these other reviewing agencies that all future electric mergers be subject to trial-type discovery and formal hearing.

In short, notwithstanding the comments of EEI and its supporters, FERC's merger policy remains instructive and supportive of BNSF's position.[19] FERC has defined its

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18 *See* EEI Reply Comments at 8.

19 EEI and its supporters focused virtually exclusively on comparisons between FERC's and the Board's processing of merger applications. While we have explained that the FERC procedures do, in fact, provide an appropriate model for the STB's processing of rail mergers – particularly after the adoption of the final rules in this proceeding – it bears emphasizing as well that railroads must compete in the general capital market to retain and attract capital. Attachment 2 to BNSF's initial comments clearly demonstrated that mergers in other sectors of the economy are frequently handled far more quickly by reviewing agencies than the lengthy timetable EEI and its supporters would have the Board assume here. Contrary to PPL's suggestion, industries in other sectors are not "unregulated," nor are they nonessential to "the country's infrastructure." PPL Reply Comments at 6. The banking industry, for example, is extensively regulated by the Federal Reserve Board, the FTC, and other agencies, and it is hard to imagine an industry more central to our "country's infrastructure." Yet, BankAmerica and NationsBank closed their $45 billion merger in 5½ months after review by *two* federal agencies. Likewise, telecommunications firms are closely regulated by the FCC, state regulatory commissions, and, sometimes, international regulators. And, in today's information-driven economy, the "information

standards of review carefully, thereby enabling the expedition of its merger review.[20] FERC issued a new Merger Policy Statement in 1996 "to ensure that mergers are consistent with the public interest and to provide greater certainty and expedition in FERC's analysis of merger applications."[21] On April 16, 1998, FERC issued its NPR to revise 18 CFR Part 33 to provide "clear and succinct filing requirements" that would allow "applicants to organize and prepare their applications more quickly and efficiently and also to better predict the outcome of the Commission's evaluation."[22] As a result of these changes, most mergers are reviewed in a few months.[23]

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superhighway" provided by the telecommunications industry is one of the most important of our country's infrastructures. Yet, MCI and WorldCom received final approval for their $44 billion transaction from the FTC, FCC, and European authorities, *all* in less than 11 months. It simply is not true that railroads are so different from these other sectors that mergers in the rail industry need to take two to three times longer to be processed. When they threaten to take such an inordinate amount of time, they place a significant burden on Class I railroads competing for capital with other sectors of the economy. BNSF Initial Comments, V.S. Cornell at 10; BNSF Initial Comments, V.S. Krebs at 2-3.

[20] For a detailed analysis of FERC's current merger rules, see Final Rule, *Revised Filing Requirements Under Part 33 of the Commissioner's Regulations*, 65 Fed. Reg. 70,984 (Nov. 28, 2000) (effective Jan. 29, 2001).

[21] Policy Statement, 61 Fed. Reg. 68,595 (Dec. 30, 1995).

[22] Notice of Proposed Rulemaking, Revised Filing Requirements (April 16, 1998), 63 Fed. Reg. 20340 (April 24, 1998).

[23] Specifically, in the past year:

- Initial orders were issued within the 150-day target for each submission;
- Average total processing time for all applications was 117 days;
- Uncontested mergers typically are processed within 60 days of filing.

Id. at 70,986-87. For more detail concerning the speed with which FERC processes

Union Pacific Corporation and Union Pacific Railway Company ("UP") argued that expedition is inappropriate because, in reviewing the next merger application, the Board will have to consider whether the creation of two transcontinental railroads would be in the public interest.[24] But, contrary to UP's implication, the Board is not going to "determine the future structure of the North American rail system" in the next rail merger proceeding. Furthermore, the principal purpose of this entire rulemaking proceeding and the merger moratorium – which was undertaken at the behest of UP, among others – was to permit the Board to establish new merger rules that will be an "appropriate framework for considering future major railroad merger proposals."[25] The Board itself has stated that the new rules will be suitable for considering applications that "will likely be the final round of restructuring of the North American railroad industry."[26] BNSF does not agree that future merger applications will necessarily be the "final round" of rail restructuring, but the point is that the *Board* believes that this rulemaking proceeding is focused on developing procedures and policies suitable for addressing the applications that may affect the "future

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mergers, see Attachment 1 hereto which is a chart of FERC-approved mergers similar to Attachment 2 to BNSF's initial comments.

[24] UP Reply Comments at 35. UP objected to BNSF's proposed expedited merger approval schedule because "[s]ix to nine months would not be sufficient to determine the future of the North American rail system." *Id.* UP also objected to the schedule proposed by BNSF and CN in their combination proceeding. Of course, the Board would determine the appropriate allocation of time among the parties in any specific case.

[25] Notice of Proposed Rulemaking, *Public Views on Major Rail Consolidations*, STB Ex Parte No. 582 (Sub-No. 1) slip op. at 10 (served Oct. 3, 2000).

[26] Decision, *Public Views on Major Rail Consolidations*, STB Ex Parte No. 582, slip op. at 2 (served March 17, 2000).

structure of the North American rail system." The final rules that emerge from this proceeding should do exactly that – eliminating the need to address these policy issues for the first time in the next merger proceeding.

For this reason, BNSF agrees in part with the U.S. Department of Transportation ("DOT") that the time to consider policy questions associated with two transcontinental railroads "is not when the transaction that would create it is presented, but in advance."[27] BNSF respectfully disagrees with DOT, however, when it proposes that the Board open an additional proceeding to consider "issues that might be involved in transcontinental mergers."[28]

That is what the Board said it was doing last year when it launched Ex Parte No. 582, the primary proceeding which led to this derivative rulemaking docket. The Board decided on its own motion to hold public hearings "to provide a forum for the expression of views . . . on major rail consolidations and the present and future structure of the North American railroad industry."[29] The Board explained that it wanted to have a "public review . . . of what the evolving structure of the North American railroad industry is and should be" and "whether it would be in the public interest" to have "significant additional

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[27] DOT Reply Comments at 11.

[28] *Id.*

[29] Notice of Public Hearings and Request for Comments, *Public Views on Major Rail Consolidations*, 65 Fed. Reg. 4568, 4569 (Jan. 28, 2000).

consolidation."[30] The Board specifically asked for "views on rail consolidation in general, and on the present and future structure of the North American railroad industry."[31]

During the course of four days of hearings, more than 130 witnesses representing "all sectors associated with the rail industry: large and small rail carriers; large and small shippers representing various commodity groups; intermodal and third party transportation providers; rail employees; state and local interests; financial analysts and economists; and Members of Congress and other federal agencies" presented extensive oral and written testimony to the Board.[32] In its March 17 decision, the Board explained that it "opened this proceeding to obtain public views on the subject of major rail consolidations and the present and future structure of the North American rail industry."[33] Based on the extensive record it amassed during the hearings, the Board announced that it was imposing a 15-month moratorium on rail mergers and instituting this derivative rulemaking proceeding (Ex Parte No. 582 (Sub-No. 1)) for the specific purpose of reexamining its merger rules "because [its] current rules [were] simply not appropriate for addressing the broad concerns associated with reviewing business deals geared to produce two transcontinental railroads."[34] Moreover, in the notice of proposed rulemaking that is the subject of this

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30 *Id.*

31 *Id.* at 4570.

32 Decision, *Public Views on Major Rail Consolidations*, STB Ex Parte No. 582, slip op. at 2 (served March 17, 2000).

33 *Id.*

34 *Id.*

rulemaking, the Board explained that it was "proposing what [it] believe[d] would provide an appropriate framework for considering future major railroad proposals."[35] Thus, another new proceeding to take testimony on these issues would be redundant.

DOT generally supported expedition of Board review of merger applications when appropriate.[36] DOT did, however, express concern that BNSF's proposed schedule might not provide affected communities with adequate opportunity to participate in the environmental review process.[37] BNSF strongly believes that, with the procedures put in place by the Board, its proposed one-year schedule would provide adequate time for environmental review process under the National Environmental Policy Act ("NEPA") and that the schedule would not adversely affect the opportunities for interested communities to participate in a meaningful and timely way in that process.

As explained in BNSF's initial comments, the pre-filing notification to the Board could become the effective initiation of the involvement of interested communities in the proceeding, thus beginning public outreach far earlier than the Board has previously done in prior transactions. Formal activities that could be initiated at this stage by the Board include scoping, public participation and community outreach. In the event that the Board were to decide not to initiate outreach activities before the filing of the application, the pre-

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35 *Id.* Specifically, the Board stated that it wanted to "make sure that [it had] the appropriate guidelines in place to assure that [it] can properly assess and fully protect the public interest in each individual case." *Id.* at 7-8.

36 DOT Reply Comments at 7.

37 *Id.* at 7-8.

filing notification and associated media coverage that would follow a merger announcement would still provide effective advance notice to interested communities of any pending transaction.[38]

Moreover, the current approach of the Board's Section of Environmental Analysis ("SEA") to community outreach is extremely proactive and includes distributing to affected communities an Environmental Overview ("EO") to initiate the public scoping process and support public and agency notification.[39] An EO (first utilized in the CN/IC transaction to provide meaningful public notice as early as possible in the process) includes a complete discussion of the anticipated activities subject to SEA's environmental review as well as detailed information on how communities can participate in the environmental review process.[40] In addition to the EO, the Board and applicants also have effectively used press releases, toll-free numbers, web sites and face-to-face meetings in their community

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38 Recent history shows that significant nationwide media attention is given to proposed rail merger transactions. In addition, irrespective of how and when communities are notified of a possible transaction, under BNSF's proposed schedule, a full 45-day comment period is provided on a draft Environmental Impact Statement ("EIS"). Interested communities, therefore, would have been notified of the proposed transaction almost five months before the draft EIS is released, providing ample time to evaluate how the transaction might affect local interests.

39 In the CN/IC proceeding, the Board distributed over 2,400 EOs to the public.

40 The EO provides substantial information about a transaction to interested communities very early in the NEPA process. It typically provides an overview of the transaction, a description of the changes in rail operations and any planned construction or abandonment activities and the location of these changes, a discussion of potential environmental issues, and a table listing each rail line segment in the combined system, the pre- and post-transaction train traffic, pre- and post-transaction hazardous materials transport, and an indication of whether the segment meets or exceeds any of the Board's thresholds for environmental analysis.

outreach efforts. The STB's regulations also require that the environmental documentation be served on state and local agencies, in recognition that these public bodies are in a better position than the Board or applicants to know issues of local concern.[41]

BNSF believes that DOT's various suggestions to impose additional affirmative obligations on applicants, separate from the STB's current NEPA processes, would only lead to unnecessary redundancy, create confusion and cause potentially conflicting information to be placed in the public domain.[42] As long as NEPA review of rail mergers is required, the most efficient mechanism to provide communities with information concerning the effects of the proposed transaction is through the NEPA process. The public and the communities are well-acquainted with the process and understand how and when to participate.

DOT's proposal that applicants be required to notify all communities of changed impacts resulting from agreements with other communities would appear to upset the structured and tested process for disclosing impacts set out under NEPA and the Council on Environmental Quality ("CEQ") regulations, as well as discourage the long-standing STB policy that applicants resolve community issues in privately-negotiated agreements.[43]

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41 49 C.F.R. 1105.10(a). Notice of the availability of environmental documentation is also published in the Federal Register.

42 Due to past problems caused by duplicative information being sent to communities, SEA has encouraged applicants to submit to SEA a preliminary draft environmental assessment or preliminary draft environmental impact statement in lieu of serving an Environmental Report on various public agencies.

43 To the extent that applicants enter into agreements with communities that result in operational changes subject to SEA's review which might affect other communities, such

Also, any requirement that applicants provide assistance to communities to participate in the review process would potentially expand the role of the third party contractor well beyond the responsibilities defined in the CEQ's and STB's rules and would be wholly impractical in determining which communities would qualify for such assistance.

Finally, critics of BNSF's proposed 12-month procedural schedule have ignored the practical effect of the Board's proposal to require significant increases in the type, amount, and detail of the information future merger applicants must include in their merger application. Since the Board is likely to require future merger applicants to provide extensive information concerning issues of service and competition with their application, there should be less need for extensive discovery "to ferret out" information from the applicants. Much of the information traditionally obtained in discovery will instead be required to be filed as a part of the application. This should eliminate the need for extensive discovery proceedings and should allow the Board to process applications more quickly.

In sum, an expedited schedule for the review of future Class I merger applications is realistic, appropriate and necessary.

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changes are already studied within the context of the NEPA review process.

II. PAST MERGERS HAVE NOT HARMED COMPETITION — INDEED THEY HAVE GENERATED SIGNIFICANT PUBLIC BENEFITS AND ENHANCED COMPETITION — AND FUTURE MERGERS CAN BE EXPECTED TO DO LIKEWISE

A number of parties in their reply comments assert that past mergers have harmed competition and have generated little or no public benefits. They use this supposed past competitive harm, as well as assertions about the likelihood of future harm, as their principal bases for supporting the Board's proposal to require "competitive enhancements" in all future mergers.[44] They also assert, echoing the Board's presumption in the NPR, that future rail mergers are unlikely to produce significant public benefits because the past problems of excess capacity and the need to rationalize the rail industry have been resolved.[45]

These assertions are remarkable for their lack of support. One would have thought, in light of the plethora of evidence that modern rail mergers have produced significant public benefits, that anyone arguing to the contrary would have produced concrete support

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[44] Alliance for Rail Competition ("ARC") Reply Comments at 2 ("[T]he Board and its predecessor allowed 'merger mania' to go too far without adequate attentiveness to ensuring customer choice . . . ."); Certain Coal Shippers Reply Comments at 3; Dow Chemical Co. Reply Comments at 4, 6; EEI Reply Comments at 13 ("Despite the ICC's and the Board's policy to preserve competition in rail mergers, rail mergers have in fact reduced competition."); IMPACT Reply Comments at 9-10; National Industrial Transportation League ("NIT League") Reply Comments at 4, 21-22; USDA Reply Comments at 3, 8; and Wheat, Barley and Grains Commissions ("WB&GC") Reply Comments at 3-4.

[45] *See, e.g.,* NIT League Reply Comments at 24 (concluding that because future mergers will be predominantly end-to-end, "the potential merger savings through the elimination of redundant investment are very likely to be limited"). *See also* WB&GC Reply Comments at 3 (arguing that only remaining efficiencies for Class I railroads to gain are through the increased number of captive shippers).

for their position. These parties' failure to do so can only be seen for what it is – an admission that they have no evidence that past mergers have harmed competition. Certainly, if competition had been reduced, we would expect that rail rates would have increased as railroads used their increased market power to garner monopoly profits. In fact, as everyone knows and as the Board recently has revalidated, rail rates have steadily decreased in real terms throughout the deregulatory, pro-merger era, and no railroad has been in a position to achieve long-term revenue adequacy, much less earn monopoly profits.

The Board's own recent analysis shows that real rates have continued to decline dramatically since 1984, even after adjusting for changes in rail services and other factors cited by shippers.[46] Furthermore, while rate reductions have been greater for shippers with multiple rail or intermodal options, rate reductions have been experienced across all segments of the industry.[47] The Board's analysis found that after adjusting for inflation, U.S. rail rates have fallen by more than 50% since passage of the Staggers Act in 1980, and by 45.3 percent since 1984.[48] Most recently, inflation-adjusted "railroad rates fell 2.7 percent in 1999, with rates in the East declining 2.6 percent and rates in the West falling

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[46] "Rail Rates Continue Multi-Year Decline" [hereinafter "STB Rate Study"], Office of Economics, Environmental Analysis, and Administration, Surface Transportation Board, December 2000, at 3-8.

[47] *Id.* at 7.

[48] *Id.* at 1, 8.

2.8 percent",[49] all in the face of a strong economy. The Board concluded that these very significant rate reductions "imply that shippers would have paid an additional $31.7 billion for rail service in 1999 if revenue per ton-mile had remained equal to its 1984 inflation-adjusted level."[50]

Ironically, some of the parties that have benefitted the most from recent mergers in the form of reduced rates are among the most vocal proponents of the argument that prior mergers have reduced, and future mergers will reduce, competition. In particular, coal shippers have enjoyed dramatic real rate reductions. The Board's analysis shows that:

> Revenue per ton for western coal movements declined from $14.75 in 1984 to $10.11 in 1999, *before adjusting for inflation*. Over the same time period, revenue per ton for eastern coal traffic declined from $10.29 to $9.25, *again before inflation*. If rail revenue per ton-mile for eastern and western coal movements had simply kept pace with inflation from 1984 to 1999, 1999 payments by coal shippers would have been $9.3 billion higher. Thus, coal represented 21 percent of 1999 rail revenues but enjoyed 29 percent of the dollar benefits of the rate reductions.[51] [Emphasis added.]

The conclusion that past mergers have not reduced competition is also supported by the Board's recent review of the UP/SP merger, in which the Board concluded that

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49 *Id.* at 1. The Board's analysis found that even without adjusting for inflation, "eastern rail rates have fallen 13.2 percent, western rail rates have fallen 24.7 percent, and rates for the nation as a whole have fallen 19.7 percent" since 1984. *Id.* at 2.

50 *Id.* at 2-3.

51 *Id.* at 7. Contrary to arguments that have been made by some shippers, the Board found that the increase in the average length of haul accounted for only a tiny fraction of the rate decrease. *Id.* ("real railroad revenue per ton has fallen 43.7 percent since 1984, nearly identical to the decline of 45.3 percent obtained when using ton-miles").

> [T]he record indicates vigorous competition and improved service in the West. Our conclusion that competition has not been undermined by this [UP/SP] and other recent mergers in the West is also confirmed by a comprehensive rate study recently released by STB staff. This study shows that rail rates in the West continued to decline rather sharply during the period from 1996 to 1999 when this merger was being implemented. In this 3-year period, western rail rates fell 9.0%, or 3.1% per year on an inflation-adjusted basis. Rail rates on coal movements in the West declined even faster, falling 14.2% in inflation-adjusted dollars, or 5.0% per year. *Rate decreases of this magnitude could not have been realized if the UP/SP and BNSF mergers had substantially decreased rail competition in the industry.*[52] [Emphasis added.]

Even aside from the direct rate evidence showing that shippers have benefitted substantially in the past from the deregulatory, pro-merger policy of the Board, the earnings history of the railroads provides independent evidence that past mergers have not reduced competition in the industry. The Board's own revenue adequacy calculations show that, while the railroads' financial condition has certainly improved, they have chronically failed to cover their cost of capital. The Board's methodology for calculating the cost of capital has been much debated, but "the figures [developed by the Board] are so dramatic that it is unlikely, regardless of adjustments, that anyone could argue that the railroads' returns on investment have consistently exceeded their economic cost of capital."[53] Certainly, Wall Street analysts do not believe that. As discussed by Professors Gómez-Ibáñez and Kalt

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[52] Union Pacific Corporation, et al. — Control and Merger — Southern Pacific Rail Corporation, et al., Finance Docket No. 32760 (Sub-No. 21) Decision No. 16 (STB December 13, 2000) at 6, footnote omitted.

[53] BNSF Initial Comments, V.S. Cornell at 7-8 and Exhibit 2.

in their rebuttal statement, analysts who follow the industry closely are concerned that railroads may never be able to cover their capital costs.[54]

Faced with this kind of evidence, shippers contending that intramodal competition in the rail industry has diminished sometimes point to the reduction in the number of Class I railroads in the United States. They suggest that, since that number has been significantly reduced, intramodal competition must have been diminished somewhere.[55] As they well know, however, the absolute number of railroads in the country has little to do with the intramodal options open to a shipper. Most carload shippers have always been served by only one railroad, and there is no evidence that recent rail mergers have made any shippers "captive" to one railroad that were not "captive" before the mergers. Given that the Board and its predecessor have always been careful to ensure that "2-to-1" shippers were protected in rail mergers, and that merging railroads have voluntarily agreed to trackage rights conditions, access to new customer facilities and transloads and shared access arrangements that have enhanced access, that is just what one would expect. But BNSF nevertheless asked Professors Gómez-Ibáñez and Kalt to analyze the relevant data.

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54 BNSF Rebuttal Comments, V.S. Gómez-Ibáñez/Kalt at 14-15. Professors Gómez-Ibáñez and Kalt point out that railroads' financial performance has consistently been worse than most industry groups. In 1999, for example, railroads ranked 34th and 37th for return on assets and return on equity, respectively, out of 41 industry groups. *Id.* at 15.

55 *See, e.g.,* Dupont Reply Comments at 1 ("[T]he industry has already concentrated to such a degree that competitive remedies that reach beyond simply the next two merger partners are needed."); PPL Initial Comments at 2 ("[s]ince 1980, the level of intramodal competition faced by the major railroads has declined precipitously" as a result of redirection in the number of Class I railroads).

Assisted by FTI Consulting, they analyzed two different data sets. The first is Freight Station Accounting Code ("FSAC") data. These data show what the railroads report every year as the individual stations they are able to serve across the country, including location by Standard Point Location Code ("SPLC").[56] Professors Gómez-Ibáñez and Kalt first used the FSAC data to analyze the number of carriers serving each SPLC in 1994, which preceded the UP/CNW, BN/ATSF, UP/SP, Conrail/NS/CSX, and CN/IC transactions. They found in that year that 82.4 percent of SPLCs were served by only one railroad and 13.7 percent were served by two carriers.[57] When they performed the same calculation for 2000, they found that the percentage of SPLCs served by one carrier had declined to 74 percent, while the percentage served by two carriers had risen to 19.1 percent.[58]

Professors Gómez-Ibáñez and Kalt next analyzed Waybill Sample data, which reflects actual shipments. They sorted the data by SPLC for locations actively served by one, two, or more railroads in 1988, 1994, and 1999. They found that 90.3 percent of the locations actually used only one railroad in 1988, compared with 88.9 percent in 1994, and

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56 A SPLC often includes more than one shipper, so it is not always possible to determine when two or more railroads serve the SPLC whether all of the shippers within the SPLC are capable of receiving service from multiple railroads, but this would simply tend to overstate the percentage of shippers that are served by multiple railroads. It does not affect the validity of a comparison of the percentage of locations served by multiple railroads before a merger and the percentage served by multiple railroads after a merger.

57 BNSF Reply Comments, V.S. Gómez-Ibáñez/Kalt at 7.

58 *Id.*

87 percent in 1999.[59] In sum, far from supporting the suggestion that mergers have resulted in more captive shippers, these data show that a higher percentage of locations are served by multiple carriers today than before the recent mergers.[60]

Some shippers suggest that the future will be different, but they do not explain why the same kinds of protections against anticompetitive harm that have been effective in past mergers would be inadequate in future mergers. In their initial comments, *all* of the parties agreed that any specific competitive harm created for any specific shippers must be remedied. For example, the NPR proposed, and BNSF and other Class I railroads agreed, that future merger applications must specify how the merged railroad will maintain options for "2-to-1" shippers, build-in/build-out options, and transloads. Thus, each shipper that currently has alternative rail options will continue to have alternative options after any future rail merger. In addition, all commenting parties agreed that mandated competitive

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59 BNSF Rebuttal Comments, V.S. Gómez-Ibáñez/Kalt at 8.

60 Some parties also challenged the Board's longstanding precedent that "4-to-3" and "3-to-2" shippers are not harmed by rail mergers. *See* EEI Reply Comments at 2, 13-14; Kansas City Southern ("KCS") Reply Comments at 8 ("Board should not approve a merger unless all existing rail options are preserved. . . . [T]he Board should do more than merely preserve competition at "2-to-1" points, as it has traditionally done. Instead, all competitive rail options should continue to exist in a post-merger environment."); IMPACT Reply Comments at 13; USDA Reply Comments at 5 ("[R]ail intramodal competition must be preserved and promoted."). BNSF strongly believes that the physical and financial characteristics of the rail network ensure that any "4-to-3" and "3-to-2" shippers are not harmed by mergers and is unaware of any evidence to the contrary. In fact, the evidence demonstrates otherwise. Nevertheless, in its comments in this proceeding, BNSF suggested that the Board continue to review the potential harm to such shippers on a case-by-case basis.

enhancements would not obviate the need for shipper-specific relief from any shipper-specific competitive harms produced by a proposed merger.[61]

Both the NPR and some commenters suggested that diminution of product and geographic competition could be a greater problem in future mergers,[62] but, here again, no evidence is presented that geographic and product competition is likely be particularly problematic in future mergers. Nor does anyone show why any question of diminution of geographic and product competition in a particular market cannot be addressed – and, if necessary, remedied – on its merits. When the issue has been raised in previous rail mergers, the evidence has not supported a finding of competitive harm through the loss of geographic or product competition.[63] As Professors Gómez-Ibáñez and Kalt discuss in their rebuttal verified statement, the factors that contribute to a finding of competitive harm through the loss of such competition are *less* likely to be in evidence in future end-to-end mergers than in the past overlapping mergers.[64] If, for example, one of the western railroads merged with one of the eastern railroads, they would not for the most part serve the same regions for most of the traffic involved. Thus, there is even less likelihood of

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61 *See, e.g.,* American Chemistry Council and American Plastics Council ("ACC") Initial Comments at 12-13; State of New York Initial Comments at 8-9.

62 USDA Reply Comments at 7 ("[S]hippers should not be denied remedies in the final merger rules to replace the loss of competitive options that shippers operating in more than one plant lose.") (citing NIT League Initial Comments at 7).

63 BNSF Initial Comments, V.S. Gómez-Ibáñez/Kalt at 17. *See, e.g., Union Pacific Corporation., et al. – Control and Merger – Southern Pacific Rail Corporation, et al.* 1 STB 233, 394-403 (1996) (geographic competition).

64 BNSF Reply Comments, V.S. Gómez-Ibáñez/Kalt at IIF.

geographic and product overlap than in previous mergers.[65] In any event, the effect of any merger on geographic and product competition can be analyzed and remedied in a particular market, just as the Board has done in the past. There is no factual foundation in the record of prior mergers or in this proceeding for the Board to presume that diminution of geographic and product competition will be a special problem in future mergers, much less an irremediable problem.[66]

In addition to asserting, with no foundation, that past and future mergers have been and will be anticompetitive, some shippers suggest, echoing the NPR, that there are few public benefits to be gained from future mergers, because there are fewer opportunities today for squeezing excess capacity out of the nation's rail system.[67] But this ignores the many other benefits of mergers. Today the rail industry faces the need to increase capacity, become more efficient in its operations, and improve service to shippers. Each of these challenges can be met by future mergers. The most efficient way to increase capacity is to better utilize existing assets, and a merged railroad will be better able to

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65 *Id.*

66 There is also no factual foundation for the contentions of several parties that the Board should reject the one lump "theory" as a standard of merger analysis for vertical mergers. EEI Reply Comments at 12-14; IMPACT Reply Comments at 20-21; NIT League Reply Comments at 23. As Professors Gómez-Ibáñez and Kalt discuss in their rebuttal statement, the Board has always permitted extensive analytic and factual investigations of the vertical implications of end-to-end mergers, and no one has yet demonstrated that the one-lump "theory" is not a powerful predictor of likely market behavior. Gómez-Ibáñez/Kalt Rebuttal V.S. at II.D.

67 *See, e.g.*, NIT League Reply Comments at 24; WB&GC Reply Comments at 3; *see also supra* § II (discussing and rebutting commenters' contention that future mergers would provide no public benefits).

manage its assets to maximize capacity. Further, a merged railroad can operate more efficiently through economies of scope and scale and the ability to make decisions based on optimizing system performance. As Robert D. Krebs, Chairman of BNSF, stated in his verified statement submitted with BNSF's initial comments, the proposed BNSF/CN combination would have led to numerous public benefits:

> These included offering shippers improved routing options, faster transit times on major routes, bypassing congested urban areas and providing unprecedented gateway and service guarantees. Our proposed combination would have produced improved asset utilization, thus increasing the capacity of the combined system without the need for additional equipment and infrastructure investment. The combination would also have yielded substantial economic synergies, freeing capital for infrastructure investment where that investment may be needed; and it would have substantially advanced the interests of North American trade as embodied in the North American Free Trade Agreement ("NAFTA"). . . .
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> The application would have described estimated total merger benefits of approximately $800 million annually, including over $300 million in additional net revenue from traffic gains, a substantial portion of which came from attracting business back to the rail system. We also projected approximately $500 million in operating synergies per year, of which $400 million would have been reduced operating costs and $100 million in avoided capital expenditures. These savings would have made the combined railroads even stronger financially, better able to compete for new business and make infrastructure investments.[68]

No commenter challenged Mr. Krebs' statement – with respect to either the nature or the scope of the benefits that a transaction like the BNSF/CN combination would produce.

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68 BNSF Initial Comments, V.S. Krebs at 7.

Accordingly, to the extent that the Board's proposed rules are premised on the assumption that future rail mergers will not yield significant public benefits, the rules cannot be justified.

Given the lack of any evidence to support a presumption of irremediable competitive harm in future mergers, BNSF submits that requiring mandated "competitive enhancements" as the price for mergers would be arbitrary and capricious. BNSF also believes it would be flawed policy. As discussed in the rebuttal statement of Professors Gómez-Ibáñez and Kalt, "experience under the Staggers Act regulatory regime has demonstrated that restructurings through mergers have played strongly positive roles in bringing the nation's railroads back from national embarrassment to an integral part of the infrastructure of a modern and growing economy."[69] No one has presented any facts to demonstrate that that will not continue to be the case. "Calls for competition 'enhancement' and forced access should be recognized for what they are: attempts to overturn the cornerstones of the highly successful Staggers Act regime."[70] The STB should not be a party to this retrograde reregulatory effort.

III. THE BOARD SHOULD NOT FAVOR ALLIANCES OVER MERGERS

Some parties oppose BNSF's position that the Board should not substitute its judgment for that of merger applicants who believe they can achieve greater benefits through mergers than through alliances.[71] As discussed in Professors Gómez-Ibáñez and

69 BNSF Rebuttal Comments, V.S. Gómez-Ibáñez/Kalt at 1.

70 *Id.* at 5.

71 WB&GC Reply Comments at 3 ("Because of the fact that mergers result in greater captivity of the railroad customers, the standards for an applicant to meet should be greater

Kalt's initial verified statement, mergers can be expected to produce benefits that mere alliances cannot. When railroads choose mergers over alliances and other types of voluntary coordination agreements, they do so because mergers are more likely to achieve the efficiencies they need.[72] A merged entity is better positioned to respond to network problems and opportunities, because of its ability to make decisions that reflect the balancing of the requirements of the entire system, rather than that part of the system served by each railroad in an alliance.

WB&GC argued that railroads will prefer mergers over alliances because mergers confer greater monopoly power than alliances.[73] But prospective merger partners well know that the Board's current and future policy provides that a merger may not eliminate a shipper's competitive options. The evidence is that they choose mergers to make themselves *more* competitive, not less, and there is no doubt that mergers have succeeded in doing precisely that.[74] Alliances were an option for railroads long before the deregulatory, pro-merger regime introduced by the Staggers Act, and they did not, and do not, accomplish the kind of efficiencies over the long term that mergers can and do.

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in a merger proceeding."); UP Reply Comments at 21 ("[T]he Board should require applicants to explain why the benefits they propose cannot be achieved through alliances . . . to ensure [the Board] receives the information necessary to perform the public interest analysis.").

72 *See* § VI of Initial V.S. Gómez-Ibáñez/Kalt for a discussion of non-merger transactions.

73 WB&GC Reply Comments at 3.

74 *See* BNSF Rebuttal Comments, V.S. Gómez-Ibáñez/Kalt at 9-13.

UP argues that favoring alliances over mergers "is an appropriate way to 'raise the bar' for future mergers" and severely mischaracterizes BNSF's position by saying that "BNSF strenuously objects to the Board's proposal to consider only merger-specific benefits." UP Reply Comments at 20. BNSF, however, does not object to the proposition that the Board should consider only merger-specific benefits. That is what the Board does now, it is what the antitrust agencies do, and it is what the Board should do. The question is not whether the Board should require that merger benefits be merger-specific, but how far it should go in declaring mergers not to be merger-specific on the basis of mere theorizing that the same benefits could be achieved through alliances that the parties have not proposed. Substituting such governmental speculation for the judgments of those in the private sector who are placing capital at risk is neither good public policy nor consistent with the practices of other agencies.

What causes other agencies to cast a skeptical eye on claimed merger benefits is that they – unlike the Board – consider such claims only *after* they decide that the merger, even after conditioning, would result in increased market power.[75] As Professor Pierce explains:

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[75] *FTC v. Cardinal Health, Inc.*, 12 F. Supp. 2d 34 (D.D.C. 1998), cited by UP at page 21 of its reply comments, takes the same approach. *After* devoting many pages (*id.* at 45-61) to the question whether the proposed mergers would harm competition – and concluding that they would – the court *then* turned to efficiencies (*id.* at 61-63) and then observed that "[t]he critical question raised by the efficiencies defense is whether the projected savings from the mergers are enough to overcome the evidence that tends to show that possibly greater benefits can be achieved by the public through existing, continued competition" (*id.* at 63). That is a sound analytic approach, but it is not the Board's approach.

> FERC rarely requires a merger applicant to prove that a proposed merger will have social benefits. Like DOJ and FTC, FERC assumes that the managers of a firm will not propose a merger unless they predict that it will have socially beneficial effects and that the managers are in a much better position than any agency to make such a prediction. As I pointed out in my original statement, that is a well supported assumption in all circumstances save one. It is not safe to assume that a proposed merger will have socially beneficial effects when it will place the firm in a position to exercise greater market power. That is why FERC, DOJ, and the FTC require a firm to prove the existence of demonstrable public benefits only in the highly unusual situation in which the agency concludes that a proposed merger would have unmitigateable anticompetitive effects so serious that the agency would be compelled to disapprove the merger in the absence of significant, demonstrable public benefits.[76]

Professors Gómez-Ibáñez and Kalt make the same point and observe that therefore UP "is suggesting an exercise that is not consistent with common procedure at the antitrust agencies."[77] "Even more fundamentally," they add, "such an approach would amount to an unjustified rejection of the sound public policy principle which recognizes that it is eminently appropriate to rely on the disciplining forces of the marketplace rather than regulation when the regulator has already determined that a merger (conditioned as necessary) does not threaten to adversely affect competition."[78]

The whole point of deregulation under the Staggers Act has been to reduce to a minimum the extent to which the Board attempts to micromanage the business judgments

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76 BNSF Rebuttal Comments, V.S. Pierce at 3-4.

77 *Id.*, V.S. Gómez-Ibáñez/Kalt at 31.

78 *Id.*

of railroads about how they can best organize their operations and systems to meet their competitive needs. For the Board to attempt to quantify the benefits that could be gained from an alliance, which the railroads have not chosen to undertake, and to presume that those benefits can substitute for the benefits of a merger transaction that they have undertaken would be overreaching. It was just this kind of regulatory micromanagement that sapped the competitive capacity of the railroads before Congress in the Staggers Act mandated greater reliance on the marketplace, and the Board should be loath to head down that road again.

IV. MANDATED OPEN ACCESS SHOULD NOT BE PURSUED THROUGH MERGER CONDITIONS

A close reading of the reply comments filed by many parties makes it apparent that they wish that the Board would impose a regime of mandatory open access on the entire rail industry.[79] The NPR is simply a convenient wedge for their long-term agenda. Thus, some parties implicitly affirmed certain initial commenters' arguments that past mergers should be reopened and open access conditions imposed.[80] Other parties argued that future mergers should be conditioned on full open access for the merging carriers, with

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79 *See, e.g.,* Consumers United for Rail Equity ("CURE") Reply Comments at § II (arguing that a majority of the shipping community supports specific pro-competitive requirements to mergers); DuPont Reply Comments at 3-5; EEI Reply Comments at § III; IMPACT Reply Comments at § A (2), (5), B (3); PPL Reply Comments at § III; USDA Reply Comments at 3-9.

80 *See, e.g.,* EEI Reply Comments at 14.

reciprocity imposed on other carriers that take advantage of such access.[81] Others were more forthright and asked the Board to restructure the entire rail industry, whether through merger policy or other means.[82]

However, the Board recently conducted a proceeding, Ex Parte No. 575, *Review of Rail Access and Competition Issues,* for the express purpose of considering whether it should revisit its positions regarding various access proposals that would apply to the industry as a whole. In the end, the Board concluded that it would not entertain proposals that would require restructuring of the rail industry absent a legislative mandate from Congress.[83]

If parties wish to ask the Board to reopen that proceeding, or begin a new proceeding to consider access proposals for the industry as a whole, that is their prerogative. But a proceeding to revise the Board's merger rules is not the place for the Board to consider restructuring the rail industry. Merger applicants should not be singled out for the application of access requirements that the Board has determined should not

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81 *See, e.g.,* IMPACT Reply Comments at 22-23 ("IMPACT favors the expansion of intramodal competition to include at least three railroads in as many major markets as possible.").

82 *See, e.g.,* CURE Reply Comments at 6 ("CURE believes that in order for the STB to carry out its obligation to protect the public interest and effectively deal with the underlying concerns that precipitated this rulemaking it must take action and apply new pro-competitive rules that apply to the entire industry irrespective of a merger."); DuPont Reply Comments at 1 ("[T]he industry has already concentrated to such a degree that competitive remedies that reach beyond simply the next two merger partners are needed.").

83 Decision, *Review of Rail Access and Competition Issues*, STB Ex Parte No. 575, slip op. (served April 17, 1998).

be applied to the industry as a whole. As BNSF discussed extensively in its initial and reply comments, such a policy could deter mergers that would not reduce competition but that would produce public benefits. FERC initially tried to use individual merger proceedings to impose open access but found it did not work.[84] FERC subsequently adopted it on an industry-wide basis, after a full consideration of all of the issues involved.[85]

This does not mean that BNSF supports an industry-wide regime of mandated open access in the rail industry. In fact, BNSF believes that mandated open access would be bad policy in the rail industry.[86] The physical, operational and financial characteristics of

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84 *See* BNSF Rebuttal Comments, V.S. Pierce at 6-8; *see also* Notice of Proposed Rulemaking, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 60 Fed. Reg. 17, 662, 17,664-68 (Apr. 7, 1995).

85 *See* Final Rule, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21, 540 (May 10, 1996).

86 FERC's specific open access and rate policies are not appropriate for wholesale import into the rail industry. FERC's regime of open access was accompanied by deregulation of large sectors of the electric industry and the guaranteed recovery of any stranded costs, essentially defined as lost revenues. To BNSF's knowledge, no advocate of mandated competitive enhancements has proposed either deregulating the rates charged for rail car service (as compared to trackage use) or proposed a mechanism for the recovery of any stranded costs by a merged carrier whose tracks or other facilities are opened for use by its competitors. FERC's rate policies with respect to merger costs build on its overall policy regarding rate base write-up for acquired facilities, a policy that derives from its adherence to depreciated original cost ratemaking in a system of comprehensive rate regulation. FERC's electric open access policies have contributed to the current crisis in California and have raised significant concerns about the industry's ability to attract future investment in transmission facilities. *See A Look At . . . Power to the People*, Washington Post, Dec. 31, 2000, at B3, which suggests that under-investment played a major role in the recent electricity crisis in California.

the rail industry are unique, and mandated open access could have highly undesirable results.

Mandated open access would threaten the ability of the rail industry to retain and attract capital. If capital markets perceive that the already inadequate returns in the rail industry will be further reduced, they will not invest in the industry. This will result in the loss of the service improvements and capacity expansions that railroads would otherwise be able to achieve.[87]

Moreover, the rail industry is very different from the other industries in which open access has been adopted. Natural gas pipelines and electric utilities carry a completely fungible product and make extensive use of backhauls, displacements and exchanges. In sharp contrast, railroads transport unique products in unique vehicles to specific shippers. The telecommunications sector carries unique messages, but it does not face the dispatch issues that drive railroad operations and, through technology, it is able to expand capacity with significantly fewer problems than the rail sector.[88]

These differences are not hypothetical. The United Kingdom embraced open access when it privatized its rail industry. As Professors Gómez-Ibáñez and Kalt discuss in detail in their rebuttal verified statement, what began as a new system of open access premised on private initiative and decentralized decision-making evolved rapidly into a system based on tight government regulation and supervision. The access fees and new

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87 *See* BNSF Rebuttal Comments, V.S. Gómez-Ibáñez/Kalt at III.B.

88 *Id.* at III.A.

investments that were supposed to be negotiated among the various rail companies, thereby allowing the parties to develop specific solutions to complex and varied network problems, are now set by the staff of government agencies. It is unlikely that these government agencies understand railroad costs and needs as well as the railroad operators themselves. As a result, capital and assets may not be used wisely and efficiently. The bottom line is that service has deteriorated in the U.K., and the rail infrastructure is suffering from under-investment and neglect.[89]

Advocates of open access often claim that it would result in a reduction in regulation. Nothing could be further from the truth. As explained by Professors Gómez-Ibáñez and Kalt, "the experience of open access policy in other network industries is that it tends to substantially *increase* regulatory burdens, because it requires new rules about pricing and other terms and conditions for use of the network, and because it increases the number of disputes for which parties have a forum to request regulatory intervention."[90] The Board would have to undertake a wholesale, and ill-advised, departure from its deregulatory, market-based oversight of the industry to apply a mandatory open access regime like those in other industries.

89 *See Id.* at III.D.

90 *Id.* at 20.

The Board should reject the invitation of many of the commenting parties for the Board to consider these major issues of industry restructuring and reregulation in the context of adopting new merger rules.[91]

V. THE SCOPE OF POST-MERGER OVERSIGHT SHOULD BE LIMITED TO THE EFFICACY OF CONDITIONS IMPOSED TO MAINTAIN COMPETITIVE OPTIONS FOR SHIPPERS AND THE REMEDY OF ANY MERGER-RELATED SERVICE PROBLEMS

In its initial and reply comments, BNSF argued that the scope of post-merger review should be carefully limited to (i) the efficacy of conditions imposed to maintain competitive options for shippers, and (ii) the remedy of any merger-related service problems.[92] BNSF demonstrated that the Board should not (and legally could not) impose post-merger conditions on a completed merger in order to remedy competitive problems created by a subsequent merger. BNSF also argued that the Board should not require merger applicants to guarantee projected public benefits, such as traffic diversions and cost savings.

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91 Even some supporters of an open access regime acknowledge here that the issue should be considered in a separate proceeding. *See, e.g.,* CURE Reply Comments at 7 (strongly advocating that the Board initiate "a separate rulemaking dealing with these issues on an industry-wide basis").

92 BNSF Initial Comments at 5; BNSF Reply Comments at 7-8, 35. In addition, BNSF proposed that any merger application specifically address the ability of the merged railroad to finance the investment program required to fully effectuate claimed merger benefits. BNSF Reply Comments at 37 ("BNSF agrees that the Board should review in merger proceedings whether the merged carrier would have the financial ability, including the ability to service merger-related debt, to carry out its service integration and infrastructure plans."). This proposal reflects BNSF's deeply held belief that the retention and attraction of capital is one of the critical issues that will determine the quality of rail service in the future.

Several parties mischaracterized BNSF's position by claiming that BNSF was asking not to be held to its service commitments.[93] That is not the case. While BNSF believes that, in light of the prevalence of contracts in the industry and the need to develop specific service parameters, the details of service guarantees should be negotiated or developed in the context of specific mergers, it agrees that any merger application must meaningfully address service issues. An application that fails to address service issues could be rejected or approved subject to service-related conditions.

However, BNSF does not believe a merged carrier should be required to guarantee traffic diversions or cost savings. These types of projections are made on a static basis and do not reflect the dynamic nature of the economy, the effect of the passage of time, or the competitive intra- and intermodal responses any future rail merger will produce. Moreover, imposing penalties based on the merger application could cause a merged carrier to make decisions that are bad for its customers, such as failing to adjust its labor or capital investment plans to reflect actual market requirements.

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93 Certain Coal Shippers Reply Comments at 10 ("[N]one of the Class I railroads is agreeable to the promulgation of regulations that would hold merging railroads responsible . . . for failing to achieve the purported service benefits of their merger."); IMPACT Reply Comments at 29 ("In chorus the big railroads have objected to any attempt to hold them to their promises of merger benefits."); New York City Economic Development Corporation Reply Comments at 1 ("[R]ailroads beg the Board's mercy and ask to be relieved of the promises they [make] in their operating plans and in other documents submitted as part of their application."); PPL Reply Comments at 18 ("Without exception [the Class I's] insist that they must not be required to keep their promises.").

VI. RAILROADS DO NOT ENJOY A PRIVILEGED POSITION OF IMMUNITY FROM THE ANTITRUST LAWS, AND APPLICATION OF ANTITRUST PRINCIPLES TO RAILROAD MERGERS WOULD REQUIRE REJECTION OF MANY OF THE SHIPPERS' MAJOR ARGUMENTS

The American Chemistry Council and American Plastics Council ("ACC") argue that railroads enjoy a privileged position of immunity from the antitrust laws and seem to suggest that practically anything the Board can do to inject more competition into the railroad industry is an appropriate response to that supposedly privileged position.[94] But ACC reasons from a mistaken premise to a flawed conclusion.

The myth that railroads enjoy some kind of general immunity from the antitrust laws is persistent but completely false. The ICCTA contains only a few antitrust immunity provisions,[95] and all but one of them are extremely narrow and of little practical consequence. Lacking any such general immunity, railroads have had to defend themselves against several antitrust lawsuits.[96] Railroads must conform their day-to-day operations in the marketplace to the antitrust laws, just like participants in any other industry. The perception that railroad "market power" stems from "antitrust immunity" completely lacks substance.

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94 ACC Reply Comments at 6 ("[I]n exchange for their sheltered, antitrust-exempt status, [railroads] should accept the types of specific pro-competitive conditions suggested by the various parties to this proceeding").

95 49 U.S.C. §§ 10706, 11321(a).

96 *See, e.g.*, *In re Lower Lake Erie Iron Ore Antitrust Litigation*, 998 F.2d 1144 (3d Cir. 1993); *Delaware & Hudson Railway Co.* v. *Consolidated Rail Corp.*, 902 F.2d 174 (2d Cir. 1990), cert. denied, 500 U.S. 928 (1991); *Pinney Dock and Transport Co.* v. *Penn Central Corp.*, 838 F.2d 1445, 1482-83 (6th Cir.), cert. denied, 488 U.S. 880 (1988).

It *is* true, however, under 49 U.S.C. § 11321(a) that railroad *mergers* are reviewed only by the Board and are not subject to Section 7 of the Clayton Act.[97] To the extent that ACC suggests that it is a worthwhile exercise in this rulemaking to examine how Section 7 of the Clayton Act would apply to railroad mergers, BNSF agrees. Indeed, through the testimony of Professor Pierce attached to its initial comments, BNSF commended to the Board the approach taken by other agencies that largely follow the DOJ/FTC Merger Guidelines.[98]

BNSF strongly disagrees with ACC, however, to the extent that ACC suggests that antitrust law would be hostile to future railroad mergers. Quite the contrary, antitrust law is instructive precisely because it *rejects* many of the arguments that ACC and other shipper groups have made in this proceeding.

Contrary to ACC's suggestion that "unique competitive harms . . . would be created by a transcontinental rail merger" because "economic studies have shown that prices are generally higher in two-competitor markets than in markets with more competitors," antitrust law uses the concept of "relevant market" with great precision, as do ICC/STB precedents.[99] The United States is not a relevant market for purposes of analyzing railroad mergers, as ACC seems to suggest, because transportation from one point in the United

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97 15 U.S.C. § 18.

98 BNSF Initial Comments, V.S. Pierce at 5-12.

99 ACC Reply Comments at 2-3 & n.2. *See* Merger Guidelines – 1992 (with 1997 revisions), § 1.0, 4 TRADE REG. REP. (CCH) ¶ 13,104, at 20,571; *Union Pacific Corporation, et al. — Control — Chicago and North Western Transportation Co., et al.,* Finance Docket No. 32133, Decision No. 25 (served Mar. 7, 1995) at 57-58, 85-86.

States to another is not fungible with transportation between other origin-destination pairs. Antitrust law, like ICC/STB precedents, would treat two merging railroads as operating within the same relevant market only at specific points and in transportation corridors in which the merging railroads compete with each other, or in other situations in which economically meaningful forms of competition (such as product and geographic competition) exist between the merging carriers. And, in the nature of end-to-end transcontinental railroad mergers, such points and corridors will be relatively few and can be dealt with on their individual merits when they are identified.

Also, contrary to ACC's suggestion, once a relevant market *has* been properly identified, antitrust law does not make the categorical judgment than three competitors will always be better for consumers than two. Rather, to decide whether a "3-to-2" reduction in *number of competitors* translates into a substantial reduction in *competition* forbidden by Clayton Act § 7, antitrust law engages in an analysis of the circumstances of the particular market in question, often aided by econometric analysis.[100] The Board's analysis

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[100] *See FTC* v. *H.J. Heinz Co.*, 116 F. Supp. 2d 190 (D.D.C. 2000) (allowing merger of two of the only three major manufacturers and distributors of jarred baby food in the United States, based largely on econometric studies showing that consumers would not be harmed by the "3-to-2" merger). Although the D.C. Circuit has granted a stay of the district court's order allowing the baby food merger, it has noted that the appellees' defenses "may yet carry the day." *FTC* v. *H.J. Heinz Co.*, 2000 WL 1741320, *2 (Nov. 8, 2000). That analysis is consistent with BNSF's point, which is that 3-to-2 situations are analyzed on their individual merits under antitrust law, as under the Board's precedents. *See* generally *United States* v. *Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990) (Clarence Thomas, J., joined by Ruth Bader Ginsburg, J.) (allowing merger of two of the only four firms that sold the relevant product in the United States between 1986 and 1989 and noting the "multiplicity of relevant factors" that can rebut a prima facie case based on concentration statistics alone).

of "3-to-2" situations has been – and should continue to be – essentially the same approach, *i.e.*, a case-by-case analysis aided by sophisticated econometric analysis of competition between the two merging railroads.[101] As the Antitrust Division of the Department of Justice recently remarked in the context of a major merger in a different industry, "[t]he number of competitors by itself, especially the number of competitors nationally, is a poor indicator of competitiveness."[102] In addition, contrary to many shippers' suggestions that the Board should abandon the "one-lump theory," antitrust law — which ACC wants the Board to apply — embraces that theory at least as vigorously as the Board and the ICC have done.[103]

Most important, antitrust law seeks to preserve – not enhance – competition via merger conditions. As the Antitrust Division recently wrote: "enforcement of the merger laws, Section 7 of the Clayton Act, is aimed at *remedying* the competitively harmful *changes* in market structure or other conditions *that result from the merger*."[104] Thus, the Antitrust Division rejected "comments that do not focus on the harm caused by the merger,

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101 *See Union Pacific Corporation, et al. — Control and Merger — Southern Pacific Rail Corporation, et al.*, 1 S.T.B. 233, 369, 387-390, 570-575 (1996).

102 *United States* v. *Aetna Inc.*, Public Comments and Response on Proposed Final Judgment, 64 Fed. Reg. 66,647, 66,649 (1999).

103 *See* 3A PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 756b (1996) (explaining theory); *Western Resources, Inc.* v. *STB*, 109 F.3d 782, 787 (D.C. Cir. 1997) (relying on earlier edition of Areeda treatise to explain and uphold Board's use of one-lump theory).

104 Public Comments and Response of the United States, *United States* v. *Enova Corp.*, 64 Fed. Reg. 3551, 3553 (1999) (emphasis added).

but rather on the harm to competition that might result from Pacific's premerger ownership of a monopoly gas pipeline."[105]

Even in industries that have undergone substantial consolidation in the recent past, the antitrust agencies seek to maintain premerger competition levels, not to enhance competition or anticipate future consolidations: "[T]he Department has no power to prevent the consummation of any transaction except to prevent or cure specific violations of the antitrust laws."[106] The agency thus concluded: "The proposed Final Judgment meets [the relevant antitrust] criteria by preserving competition in domestic grain markets, as it existed prior to the transaction. . . . If Cargill were to attempt to acquire competitors in additional markets, the Department will have the opportunity to investigate those acquisitions and to seek remedies for any transactions that violate the antitrust laws."[107]

Thus, ACC is correct to say that antitrust standards provide useful guidance about how the Board should review mergers, but the lessons to be gleaned from antitrust law support BNSF's positions on many of the substantive issues in this proceeding: transcontinental mergers threaten no unique competitive harm; "3-to-2" issues should be

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105 *Id.* There is no truth to the assertion by some commenters that the FTC engaged in competition enhancement, rather than competition preservation, in its recent decision to approve the merger of AOL and Time Warner. The FTC, in its own words, "accepted a proposed consent order *that would remedy the likely anticompetitive effects of the proposed merger.*" FTC Press Release, "FTC Approves AOL/Time Warner Merger with Conditions" (Dec. 14, 2000).

106 *United States* v. *Cargill, Inc.*, Public Comment and Plaintiff's Response, 65 Fed. Reg. 15,982, 15,990 (2000).

107 *Id.* at 15,988 n.12.

examined on a case-by-case basis through empirical study, just as the Board has done in the past; the one-lump theory should be retained; and merger conditions should remedy merger-related harm, not attempt competitive enhancements or anticipate future mergers.

VII. THE PRO-MERGER AND DEREGULATORY POLICIES OF THE ICCTA LIMIT THE BOARD'S AUTHORITY TO ADOPT MANY OF THE PROPOSED REGULATIONS

In its initial comments, BNSF demonstrated that the NPR's proposed alteration of the Board's existing pro-merger and deregulatory policies would be inconsistent with the Board's statutory authority.[108] Specifically, BNSF showed, through extensive citations to pertinent statutory provisions and the ICCTA's legislative history, that (a) the Board lacks the authority to institute a presumption that the benefits of mergers are outweighed by their disadvantages;[109] (b) notwithstanding concerns about further rail industry consolidation, Congress, in the ICCTA, chose to continue the existing pro-merger policy of the 4R Act of 1976 and the Staggers Rail Act of 1980;[110] and (c) the proposed rules would be inconsistent with the ICCTA's continuation of the existing policy of railroad industry deregulation.[111]

Most of the parties have failed to address BNSF's statutory arguments in their reply comments. NIT League, however, attempts to reply to BNSF's statutory arguments by

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108 BNSF Initial Comments at 27-32.

109 *Id.* at 28 n.22.

110 *Id.* at 29-30.

111 *Id.* at 30-32.

focusing on the ICCTA's retention of a flexible "public interest" standard.[112] NIT League also argues that "the fact that Congress" was aware that the rail industry was "entering a new round of consolidations, and chose not to change the statutory 'public interest' standard . . . does not mean that the legislative body was enshrining the Board's then-current merger policy for all time . . . ."[113] Finally, NIT League argues that the proposed rules are consistent with the language of the Rail Transportation Policy set forth in 49 U.S.C. § 10101.[114] Each of these arguments is unavailing.

First, although the "public interest" standard affords the Board some flexibility in considering merger proposals, it does not give the Board *unrestricted* discretion and certainly does not license the Board to overrule Congress' considered decision that the ICCTA would continue the pro-merger and deregulatory policies of the 4R and Staggers Acts.[115]

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112 NIT League Reply Comments at 18-20.

113 *Id.* at 19-20. Similarly, the National Grain and Feed Association ("NGFA") asserts that the ICCTA does not incorporate a pro-merger policy and that, therefore, the Board may alter its interpretation of the statutory public interest standard as it sees fit, subject only to the requirement that the Board have a reasoned basis for such an alteration. NGFA Reply Comments at 2-3.

114 NIT League Reply Comments at 20.

115 *Cf. Office of Communication of the United Church of Christ v. FCC*, 707 F.2d 1413, 1424 (D.C. Cir. 1983) ("It is beyond cavil that, notwithstanding the acknowledged breadth of the Commission's powers to codify by regulation its view of the public interest, courts remain 'the final authorities on issues of statutory construction . . . and "are not obliged to stand aside and rubber-stamp their affirmance of administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute"'.") (quoting *Volkswagenwerk Aktiengesellschaft v. FMC*, 390 U.S. 261, 272 (1968) and *NLRB v. Brown*, 380 U.S. 278, 291 (1965)).

Second, contrary to what NIT League and NGFA imply, in the ICCTA, despite being aware that the rail industry was entering a new round of consolidations, Congress chose to retain not just the "public interest" standard but also, as BNSF's detailed recitation of the ICCTA legislative history shows, the pre-existing pro-merger and deregulatory policies.[116] Thus, Congress *did* "enshrin[e]" pro-merger and deregulatory policies in the ICCTA, and there is no basis for the suggestion that the Board may alter those substantive legislative policy judgments in the absence of legislation authorizing such a change.[117]

Finally, NIT League's citation to the ICCTA's policy favoring the use of competition and the laws of supply and demand "to establish *reasonable rates* for transportation by rail"[118] cannot salvage *merger* rules that flout Congressional policies favoring mergers and deregulation. By the same token, the other pro-competitive, deregulatory provisions of the Rail Transportation Policy (49 U.S.C. § 10101), such as those cited by Dow Chemical

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116 BNSF Initial Comments at 29-32.

117 NIT League Reply Comments at 20. In its reply comments, NIT League suggests that BNSF has argued that, in the ICCTA, Congress enshrined the Board's then-current merger policy in its entirety. *See id.* at 20 (citing BNSF Initial Comments at 29-30). NIT League misconstrues BNSF's position. BNSF has never argued that, in the ICCTA, all of the Board's merger policies and procedures were set in stone and immunized from any and all change. To the contrary, BNSF has recognized that the Board may alter its merger policies and procedures — such as by requiring service implementation plans and making other service-related changes to merger policies and procedures. In fact, in its proposed combination with CN, BNSF repeatedly expressed a willingness to accept a raising of the bar in such areas. What BNSF showed in its comments, however, is that, in the ICCTA, Congress made fundamental policy choices to continue the existing pro-merger and deregulatory policies, and the Board would run afoul of its statutory mandate if it promulgated rules that are inconsistent with Congress's fundamental pro-merger and deregulatory policies.

118 49 U.S.C. § 10901(a) (emphasis added).

Company in its reply comments at pages 12-13, also fail to justify the Board's promulgation of merger rules that would undermine the pro-merger, deregulatory regime that the ICCTA was intended to continue and advance.

VIII. CONCLUSION

In the face of a general move toward deregulation in the United States and throughout the world, the NPR proposes to follow the different path of imposing competitive enhancements as a condition to future mergers. This approach would impose significant financial and operational costs on shippers, Class I railroads, regional and short line carriers, and ports. The result would be a flight of capital from the industry and the possible failure of Class I carriers to attain the service improvements that shippers, regional and short line carriers, and ports demand.

Therefore, any final rule adopted by the Board in this proceeding should reflect the following key principles:

- First, the Board should act on a Class I merger application within 12 months of the pre-filing notice, using the proposed schedule included as Attachment 1 to BNSF's initial comments. Prompt Board action is necessary to serve the interests of shippers, railroads and other interested parties. It also is required to assure continued access to capital markets for the industry.
- Second, the final regulations should not impair the ability of railroads to attract the capital required to make the investments necessary to expand rail capacity and meet shippers' service expectations. Proposals that would increase regulatory uncertainty,

eliminate finality in merger review, and impose onerous new regulatory requirements on railroads that would adversely affect their ability to cover their capital costs should be rejected.

- Third, and closely related to the prior point, the Board should reject the many calls for the extensive reregulation of the rail industry, whether raised in this review of the Board's merger review policy or on a more general basis. Fundamental changes to the existing regulatory structure, such as those inherent in the NPR and vigorously advocated by some commenters, would have far-reaching and detrimental consequences for the rail industry (and, as BNSF showed in its initial comments, would be contrary to the Board's statutory authority and therefore unlawful). Capital-intensive network industries, particularly the rail industry, depend upon differential pricing. Mandatory schemes for "open access," however labeled or justified, would entail comprehensive economic and service reregulation of the industry and threaten service quality. Furthermore, as evidenced by calls to apply these remedies to past mergers or to the entire industry, these proposals are not directly related to the revision of merger rules undertaken by the Board. Therefore, the Board should maintain its policy of not imposing non-remedial competitive enhancements on Class I mergers. It also should reject broader calls for reregulation of the rail industry and adhere to its position that merger policy is not an appropriate vehicle for a reversal of the policies of the 4R and Staggers Acts. Any such reversal, in any case, could be enacted only by Congress, not the Board.

- Fourth, BNSF urges the Board to continue its tested practice of reviewing the merits of proposed mergers on the basis of case-specific records, accepting (or imposing) conditions that maintain effective competitive alternatives for directly affected shippers. The Board should not replace this case-by-case review with the three presumptions that are the foundation of the NPR. The presumptions are unsupported by the NPR itself or by specific facts in the initial comments and, as shown in the comments of BNSF and the supporting verified statements, are inaccurate. If these presumptions are properly rejected, there would be no basis for the proposed requirement that merging carriers offer *non-remedial*, mandated "competitive enhancements." Furthermore, the Board should not, as some commenters suggested, ignore either intermodal competition or the evidence of strong intra-modal competition when reviewing the benefits of competitive enhancements which are to be created by and part of the proposed transaction itself or voluntarily offered by merging carriers.

- Fifth, BNSF, joining almost all the commenters in this proceeding, supports the NPR's emphasis on detailed review of the plans of merger applicants for implementing their mergers and continuing review of service performance issues during the oversight period. BNSF and the entire rail industry are committed to avoiding any repetition of the temporary service problems that followed the UP/SP and Conrail/CSX/NS combinations. However, the Board should not adopt the proposals of those commenters who believe that the Board's merger regulations should specify the remedies and/or procedures, including mandatory arbitration at the election of the shipper, to be followed in the unlikely event there are significant merger-related service problems in the future. Shippers already may pursue remedies through the Board's Ex Parte No. 628 procedures, as well as through law suits and the provisions of many service contracts. Additional remedies and procedures, if necessary, should be developed in each merger proceeding, but any remedies should be limited to *merger-related* service problems.

Respectfully submitted,

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Attachment 1

FERC Electric Merger Summary/Timeline (1995 - 2000)[1]

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
1	EC95-3-000	Delmarva Power & Light Company/ Conowingo Power Co.	11/4/94	5/17/95 Approved	6+ months	• written protests or motions due 12/5/94; • Commission approved merger on the papers, without holding a hearing.
2	EC95-16-000	Wisconsin Elec. Power Co./ Northern States Power Company (Minnesota)/ Northern States Power Company (Wisconsin)	7/10/95, Amended 10/10/95	5/14/97 Opinion Issued; 5/21/97 Application Withdrawn	N/A	• applicants held meetings week of 7/31/95 to discuss filing with interested parties; • written motions or protests due 8/28/95; • hearing order issued 1/31/96; • hearing held 5/5-12, 1996; • ALJ's initial decision approving merger 8/29/96; • Commission affirmed ALJ's decision in part but required applicants to enter into settlement negotiations before final approval of merger.
3	EC96-2-000	Public Service Company of Colorado/ Southwestern Public Service Co.	11/9/95	3/12/97 Conditionally Approved	16+ months	• written motions or protests due 12/8/95; • expedited hearing order issued 6/26/96; • hearing held 9/24-26, 1996; • ALJ certified settlement agreement 12/3/96; • Commission conditionally approved settlement and authorized merger.

[1] This information was compiled on January 10, 2001, from the following pages on the FERC web site (http://www.ferc.fed.us): the Commission Issuance Posting System ("CIPS") (updated on a continuous basis); and the FERC Electric Power Regulation link to "Mergers and Other Corporation Application Information" (updated Dec. 18, 2000). The fact that FERC approval was received does not necessarily indicate that a listed transaction was consummated by the parties.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
4	EC96-7-000	Union Electric Company/ Central Illinois Public Service Company	12/22/95, Amended 1/5/96	10/15/97 Approved	21+ months	• written motions or protests due 1/31/96; • out-of-time motion to intervene granted 2/14/96; • hearing order issued 10/16/96; • evidentiary hearing held 1/29 - 2/26, 1997; • ALJ's initial decision 4/30/97 with merger conditions; • Commission approved merger and overruled ALJ's conditions.
5	EC96-10-000	Baltimore Gas & Elec. Co./ Potomac Electric Power Co.	1/11/96	4/16/97 Approved	15+ months	• written motions or protests due 2/20/96; • hearing order issued 7/31/96; • applicants filed settlement resolving all rate issues 9/27/96; • hearing held 10/21-24, 1996; • ALJ certified record 10/25/96; • Commission approved settlement and authorized merger.
6	EC96-13-000	IES Utilities, Inc./ Interstate Power Company/ Wisconsin Power & Light Company	3/1/96, Third Supplement Filed 9/12/96	11/12/97 Conditionally Approved	20+ months	• written motions or protests due 9/30/96; • hearing order issued 1/15/97; • prehearing conference held 4/4/97; • hearing held 4/23-5/2, 1997; • applicants filed partial settlement agreement 6/2/97; • ALJ initial decision approving Competition Stipulation and merger 7/3/97; • Commission approved Competition Stipulation and authorized merger with additional condition.
7	EC96-30-000	Western Resources, Inc.	8/22/96	N/A Withdrawn	N/A	• written motions or protests due 9/30/96.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
8	EC96-36-000	Enron Corporation/ Portland General Corp.	9/20/96, Amended 10/16/96	2/26/97 Approved	5+ months	• written motions or protests due 11/6/96; • Commission approved merger on the papers, without holding a hearing.
9	EC97-5-000	Ohio Edison Company/ Centerior	11/8/96, Amended Several Times; Final Supplement 8/8/97	10/29/97 Conditionally Approved	11+ months	• written motions or protests due 12/6/96; • Commission gives applicants option of hearing or to submit mitigating documentation 7/16/97; • applicants submitted compliance filing 8/8/97; • final comments on applicants' latest submissions due 8/18/97; • final comments received 10/14/97; • Commission conditionally approved merger with mitigation measures modified and clarified.
10	EC97-7-000	Atlantic City Electric Co./ Delmarva Power & Light Co.	11/27/96, Amended 3/10/97	7/30/97 Approved	8+ months	• written motions or protests due 12/26/96; • final comments on applicants' latest submissions due 5/5/97; • applicants filed answer to motions 5/20/97; • Commission approved merger on the papers, without holding a hearing.
11	EC97-12-000	San Diego Gas & Electric Company / Enova Energy, Inc.	1/27/97	6/25/97 Conditionally Approved	4+ months	• written motions or protests due 3/28/97; • applicants filed answer to motions 4/14/97; • Commission approved merger on the papers, without holding a hearing.
12	EC97-13-000	Duke Power Company/ PanEnergy Corporation	2/3/97	5/28/97 Approved	3+ months	• written motions or protests due 4/4/97; • applicants filed answer to motions 4/14/97; • Commission approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
13	EC97-19-000	Long Island Lighting Co./ Brooklyn Union Gas Co.	3/17/97	7/16/97 Approved	3+ months	• written motions or protests due 5/16/97; • applicants filed answer to motions 6/2/97; • Commission approved merger on the papers, without holding a hearing.
14	EC97-20-000	Destec Energy, Inc./ NGC Corporation	3/17/97	6/25/97 Approved	3+ months	• written motions or protests due 5/16/97; • applicants filed answer to motions 5/30/97; • Commission approved merger on the papers, without holding a hearing.
15	EC97-22-000	PG&E Corporation / Valero Energy Corporation	3/24/97	7/16/97 Approved	3+ months	• written motions or protests due 5/23/97; • applicants filed answer to motions 6/9/97; • Commission approved merger on the papers, without holding a hearing.
16	EC97-23-000	Morgan Stanley Capital Group Inc./ Dean Witter, Discover & Co.	3/25/97	4/30/97 Approved	1+ months	• written motions or protests due 4/9/97; • applicants filed answer to motions 4/24/97; • Commission approved merger on the papers, without holding a hearing.
17	EC97-24-000	NorAm Energy Servs., Inc./ Houston Industries, Inc.	3/27/97	7/30/97 Approved	4+ months	• written motions or protests due 5/27/97; • Commission approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
18	EC97-46-000	Allegheny Energy, Inc./ DQE, Inc.	8/1/97	3/22/99 Terminated	19+ months	• written motions or protests due 10/3/97; • applicants filed answer to motions 10/17/97; • Commission rejected answer, directing applicants to negotiate with intervenors & issuing hearing order 9/16/98; • ALJ held prehearing conference 10/29/98; • Allegheny filed suit against DQE in federal court and asked for indefinite delay on hearing date; • ALJ held 2nd prehearing conf. 1/28/99; • Allegheny submitted Report of Consensus, stating that applicants did not object to terminating all proceedings 2/8/99; • ALJ's initial decision to terminate proceeding without prejudice; • Commission's notice of finality of ALJ's decision.
19	EC97-56-000	Western Resources Inc./ Kansas City Power & Light Company	9/18/97, Amended 8/7/98 & 12/2/98	10/21/99 Proposed Settlement Offer Certified	25+ months	• applicants asked case to be held in abeyance while they negotiated a revised merger agreement 1/9/98; • final comments, protests or motions due 2/7/99; • hearing before ALJ ordered 3/31/99; • prehearing conference held 4/22/99; • applicants filed proposed offer of settlement 9/14/99; • prehearing conference held 10/19/99; • ALJ certified proposed offer of settlement 10/21/99. • Board of Public Utilities of Kansas City, Kansas withdrew its objections 10/6/99.
20	EC98-2-000	Louisville Gas and Electric Company/ Kentucky Utilities Company	10/9/97	3/27/98 Approved	5+ months	• written motions or protests due 12/8/97; • Commission approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
21	EC98-7-000	Salomon Inc. (Phibro)/ Travelers Group, Inc.	10/21/97	11/26/97 Approved	1+ months	• written motions or protests due 11/21/97; • applicants filed answer to motions 11/24/97; • Commission approved merger on the papers, without holding a hearing.
22	EC98-8-000	Wisconsin Energy Corp./ Edison Sault Electric Co.	10/22/97	4/22/98 Approved	6 months	• written motions or protests due 12/22/97; • applicants filed answer to motions 1/6/98; • Commission approved merger on the papers, without holding a hearing.
23	EC98-23-000	Duke Energy Corporation/ Nantahala Power & Light Co.	12/22/97	6/1/98 Approved	5+ months	• written motions or protests due 3/13/98; • Commission approved merger on the papers, without holding a hearing.
24	EC98-27-000	WPS Resources Corp./ Upper Peninsula Energy Corp.	1/23/98	5/27/98 Approved	4+ months	• written motions or protests due 3/24/98; • Commission approved merger on the papers, without holding a hearing.
25	EC98-40-000	American Electric Power Company/ Central and South West Corporation	4/30/98	3/15/00 Conditionally Approved	22+ months	• written motions or protests due 6/30/98; • time for applicants to answer extended to 7/15/98; • hearing order issued 11/10/98; • discovery disputes lead to interlocutory appeal filed 1/26/99 and dismissed 2/17/99 when parties settle their differences, although discovery disputes continued until the hearing; • hearing held 6/29 - 7/19/99; • ALJ initial decision approving parties' Stipulations and merger 11/23/99; • Commission approved Stipulations and authorized merger with additional conditions.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
26	EC98-62-000	Consolidated Edison Co. of New York, Inc./ Orange and Rockland Utilities, Inc.	9/9/98	1/27/99 Approved	4+ months	• written motions or protests due 11/16/98; • Commission approved merger on the papers, without holding a hearing.
27	EC98-63-000	MidAmerican Energy Holdings Company/ CalEnergy Company, Inc.	9/14/98	12/16/98 Approved	3+ months	• written motions or protests due 11/16/98; • applicants filed answer to motions 12/1/98; • Commission approved merger on the papers, without holding a hearing.
28	EC99-1-000	Sierra Pacific Power Co./ Nevada Power Company	10/2/98, Supplement Filed 10/9/98	4/15/99 Approved	6+ months	• written motions or protests due 12/2/98; • Commission approved merger on the papers, without holding a hearing.
29	EC99-33-000	BEC Energy/ Commonwealth Energy System	2/8/99, Supplements Filed 5/14/99 & 6/4/99	7/1/99 Approved	4+ months	• written motions or protests due 4/12/99; • applicants filed answer to motions 4/27/99; • written motions or protests to supplements due 6/1/99; • Commission approved merger on the papers, without holding a hearing.
30	EC99-40-000	CILCORP Inc./ The AES Corporation	2/19/99	6/16/99 Conditionally Approved	3+ months	• written motions or protests due 4/22/99; • Commission approved merger on the papers, without holding a hearing, subject to conditions.
31	EC99-48-000	Sempra Energy/ KN Energy, Inc.	3/9/99 & 4/6/99	N/A Withdrawn	N/A	• written motions or protests due 5/10/99.
32	EC99-49-000	New England Electric System/ National Grid Group plc	3/10/99, Supplemented Through 5/27/99	6/16/99 Approved	3+ months	• written motions or protests due 6/10/99; • Commission approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
33	EC99-50-000	PacifiCorp/ ScottishPower plc	3/10/99	6/16/99 Approved	3+ months	• written motions or protests due 5/10/99; • applicants filed answer to motions 5/24/99; • Commission approved merger on the papers, without holding a hearing.
34	EC99-70-000	New England Electric System/ Eastern Utilities Associates	5/5/99, Supplemented Through 7/1/99	9/29/99 Conditionally Approved	4+ months	• written motions or protests due 7/6/99; • applicants filed answers 6/21-6/28, 1999; • late motion and protest filed 9/3/99; • applicants filed answer to late motion 9/20/99; • Commission conditionally approved merger on the papers, without holding a hearing.
35	EC99-73-000	El Paso Energy Corp./ Sonat Inc.	5/12/99, Amended 6/17 & 7/6, 1999	9/29/99 Approved	4+ months	• written motions or protests due 7/12/99; • late motion and protest filed 8/6/99; • Commission approved merger on the papers, without holding a hearing.
36	EC99-81-000	Dominion Resources, Inc./ Consolidated Natural Gas Co.	6/7/99	11/10/99 Conditionally Approved	5+ months	• written motions or protests due 8/6/99; • applicants filed answer to motions 8/24/99; • intervenors reply to answer & applicants answer reply 9/8-11/8, 1999; • Commission conditionally approved merger on the papers, without holding a hearing.
37	EC99-99-000	Illinova Corp./ Dynegy Inc.	7/23/99	11/10/99 Approved	3+ months	• written motions or protests due 9/21/99; • Commission approved merger on the papers, without holding a hearing.
38	EC99-101-000	Northern States Power Co. (Minnesota)/ New Century Energies, Inc.	7/30/99	1/12/00 Approved	5+ months	• written motions or protests deadline extended to 10/12/99; • Commission approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
39	EC99-106-000	Southern Indiana Gas and Electric Co./ Indiana Gas Co.	8/13/99	12/20/99 Approved	4+ months	• written motions or protests due 10/13/99; • Commission approved merger on the papers, without holding a hearing.
40	EC99-109-000	Pennsylvania Enterprises/ Southern Union Co.	8/27/99	11/01/99 Approved	2+ months	• written motions or protests due 10/27/99; • no comments received; • Commission approved merger on the papers, without holding a hearing.
41	EC00-1-000	Energy East Corp./ CMP Group, Inc.	10/1/99, Amended 12/10/99	4/3/00 Approved	6+ months	• written motions or protests due 1/20/00; • Commission approved merger on the papers, without holding a hearing.
42	EC00-26-000	Commonwealth Edison Co./ PECO Energy Co.	11/22/99	4/12/00 Approved	4+ months	• written motions or protests due 1/21/00; • applicants filed answer to motions 2/7/00; • Commission approved merger on the papers, without holding a hearing.
43	EC00-27-000	UtiliCorp United, Inc./ St. Joseph Light & Power Co.	11/23/99	7/26/00 Conditionally Approved	8+ months	• written motions or protests due 1/24/00; • applicants filed consolidated response to motions 2/7/00; • applicants & intervenors filed responses & clarifications 2/28-6/21, 2000; • Commission conditionally approved merger on the papers, without holding a hearing.
44	EC00-28-000	UtiliCorp United, Inc./ The Empire District Electric Co.	11/23/99	7/26/00 Conditionally Approved	8+ months	• written motions or protests due 1/24/00; • applicants & intervenors filed responses & clarifications 2/28-6/21, 2000; • Commission conditionally approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
45	EC00-49-000	Consolidated Edison, Inc./ Northeast Utilities	1/14/00	6/1/00 Approved	4+ months	• written motions or protests due 3/14/00; • applicants filed answer to motions 3/29/00; • Commission approved merger on the papers, without holding a hearing.
46	EC00-55-000	Florida Progress Corp./ CP&L Energy, Inc.	2/3/00, Amended 3/14/00 & 5/31/00	7/12/00 Approved	5+ months	• written motions or protests due 4/3/00; • applicants filed answer to motions 4/27/00; • Commission approved merger on the papers, without holding a hearing.
47	EC00-63-000	Sierra Pacific Power Co./ Nevada Power Company/ Portland General Electric	3/3/00, Response to Order 8/25/00	11/24/00 Conditionally Approved	8+ months	• written motions or protests due 5/3/00; • applicants filed answers to motions by 6/9/00; • intervenor's request to restart the merger process denied 7/26/00; • Commission denied request for hearing, rejected applicants' answers, and directed applicants to provide additional information 7/26/00; • applicants responded to order 8/25/00; • written motions or protests to supplemental response due 9/25/00; • Commission conditionally approved merger.
48	EC00-66-000	Consolidated Water Power Co./ Stora Enso Oyj	3/23/00	6/15/00 Approved	2+ months	• written motions or protests due 5/22/00; • Commission approved merger on the papers, without holding a hearing.
49	EC00-67-000	PowerGen plc/ LG&E Energy Corporation	3/24/00, Supplement Filed 4/28/00	6/29/00 Approved	3+ months	• written motions or protests due 5/23/00; • Commission approved merger on the papers, without holding a hearing.
50	EC00-70-000	Interstate Power Company/ IES Utilities, Inc.	3/31/00	7/7/00 Approved	3+ months	• written motions or protests due 5/30/00; • Commission approved merger on the papers, without holding a hearing.

No.	Lead Docket No.	Principal Merging Entities	Date Filed with FERC	Date Order Issued	Total Time	Procedural History/Relevant Factors
51	EC00-73-000	El Paso Energy Corp./ Coastal Corporation	4/3/00	7/26/00 Approved	3+ months	• written motions or protests due 6/2/00; • Commission approved merger on the papers, without holding a hearing.
52	EC00-75-000	NiSource Inc./ Columbia Energy Group	4/10/00	7/26/00 Approved	3+ months	• written motions or protests due 7/3/00; • Commission approved merger on the papers, without holding a hearing.
53	EC00-76-000	Indeck Capital, Inc./ Black Hills Corporation	4/10/00, Supplement Filed 4/27/00	6/16/00 Approved	2+ months	• written motions or protests due 6/9/00; • no comments were received; • Commission approved merger on the papers, without holding a hearing.
54	EC00-106-000	Entergy Power Marketing Corp./ Koch Energy Trading, Inc.	6/21/00, Supplement Filed 9/26/00	11/24/00	5+ months	• written motions or protests due 10/11/00. • Commission approved merger on the papers, without holding a hearing.
55	EC01-13-000	Bangor-Hydro Elec Co./ Emera Incorporated	11/1/00	N/A Pending	N/A	• written protests or motions due 12/29/00.
56	EC01-22-000	FirstEnergy Corp./ GPU, Inc.	11/9/00	N/A Pending	N/A	• written motions or protests due 1/30/01.
57	EC01-33-000	FPL Group/ Entergy Corp.	11/30/00	N/A Pending	N/A	• written motion or protests due 1/30/01.

CERTIFICATE OF SERVICE

I do hereby certify that copies of The Burlington Northern and Santa Fe Railway Company's Rebuttal Comments are being served on all parties of record this 11th day of January, 2001.

David I. Bloom

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (Sub-No. 1)
PUBLIC VIEWS ON MAJOR RAIL CONSOLIDATIONS

VERIFIED REBUTTAL STATEMENT OF

JOSÉ A. GÓMEZ-IBÁÑEZ
AND
JOSEPH P. KALT[1]

I. INTRODUCTION

As we stressed in our opening comments, it is eminently reasonable for public policymakers to concern themselves with devising and implementing merger policies that protect the public interest. This is certainly true in the case of the railroad industry. The public has an abiding interest in an efficient and dynamic rail network, and experience under the Staggers Act regulatory regime has demonstrated that restructurings through mergers have played strongly positive roles in bringing the nation's railroads back from national embarrassment to an integral part of the infrastructure of a modern and growing economy.

Sound merger policy for the railroad industry promotes the public's interest by protecting against diminutions in competition and/or disruptions in transportation service that a merger might otherwise portend. When these objectives are embodied in policy,

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the economics of rail mergers are driven by powerful marketplace incentives to seek out service improvements and operating efficiencies that redound to the health of the nation's economy. Proper merger policy thus protects the public interest and lets market forces do their job of determining who owns what assets and the uses to which rail resources are put.

In the present proceeding, many commenters urge the STB to now go beyond the dictates of sound economic policy by adopting vague standards that would seek to compel parties to a rail merger to condition their transaction on measures that would "enhance" competition relative to the non-merger *status quo*. In addition, many of these same commenters support the imposition of after-the-fact regulatory penalties of some form in the event post-merger rates and/or service levels did not match pre-transaction expectations. These recommendations constitute a "paradigm shift" in federal rail merger policy founded on numerous explicit and implicit assertions to the effect that past merger policy has failed to protect competition, that mergers in the rail industry can no longer yield nontrivial improvements in rail service and operations, and that the Board's current standards and tools for merger review are inadequate and biased towards harming competition.

The numerous comments of parties seeking a "competition enhancement" approach to rail merger review are marked by vociferous and loquacious assertions that "the mergers of the last decade have eroded rail to rail competition,"[2] that the Board has abetted a "relentless drive" to expand market power of "big railroads,"[3] that the future is one of impending "duopoly,"[4] and that railroads have become "monolithic" businesses that are "unresponsive to the customer."[5] At the same time, these comments are marked by virtually a complete absence of factual evidence. We believe that:

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2 Reply Comments of the Committee to Improve American Coal Transportation ("IMPACT") at 10.
3 IMPACT Reply Comments at 5-6.
4 PPL Generation, LLC and PPL Montana, LLC Reply Comments at 3, 16, 21.
5 American Chemistry Council and American Plastics Council Reply Comments at 6.

- The Facts do not indicate that the Board's past approach to mergers has resulted in reduced competition. Freight station and Waybill statistics show that the number of shipper locations with access to two or more railroads has increased since the second half of the 1980s. Moreover, STB data show that average rail rates have followed a more or less continuous decline in and through the 1990s. Concomitantly, the *sine qua non* of abused market power – excess profits – cannot be gleaned from any of multiple sources of applicable data. In fact, the data show that railroads have become less profitable relative to other industries in the 1990s. In short, some sort of "competition enhancement" standard cannot be justified on any finding that the Board has failed under its current standards to protect competition or that the Class I mergers of note have reduced competition in the rail sector.

- Assertions that any future mergers must, and can only, harm competition are similarly unsupported by the facts. The Board's vigilant attention to protecting shipper options in merger review ensures that railroad mergers are driven by efficiency rather than the pursuit of market power. As we have stressed previously, the very notion that "the next" merger will *per force* trigger "responsive" follow-on mergers depends at its core on the ability of such "triggering" restructurings to generate efficiencies and/or service improvements that make merging railroad systems more attractive to consumers. Mergers that enhance the merging parties' market power drive consumers toward other railroads and transportation modes. They do the opposite of compelling other railroads to merge in order to "keep up." In addition, the service improvements and efficiencies that can arise from expanding single-line service and the concomitant limitations of so-called "nonmerger" alternatives are demonstrably substantial – as seen in the vivid example of BNSF's traffic growth at previous interchange points between Burlington Northern and the Santa Fe.[6]

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[6] V.S. of Jose A. Gomez-Ibanez and Joseph P. Kalt at 26. See, also, Figure 9 discussed below.

- The data examined below demonstrate that competition-protecting remedial conditions (such as haulage and trackage rights) adopted in the course of previous mergers under the Board's clearly articulated standards are being used extensively by the market as competitive alternatives. Whether it is horizontal competition that is threatened or vertical consequences which entail prospective "one lump" issues, the Board remains armed with the capacity to continue to investigate the facts of each case and to compel remedial conditions. There is no factual basis for presuming that the Board will be any less vigilant and successful in protecting competition in the future han it has been in the past.
- Proponents of a "paradigm shift" to a policy of enhancement, rather than protection, of competition apparently envision future Class I mergers as being conditioned on increasing the number of rail carriers (reaching at least those shippers that are politically well-positioned and/or litigious) *relative to the number of pre-merger rail options*. This would become the "price" of obtaining merger approval from the Board. How a net increase in the number of rail options would be achieved varies across commenters in this proceeding, with recommendations ranging from divestiture to open access on roadbed infrastructure.[7] The effect, however, is invariably some form of forced access to merging railroads' facilities and services. The theories behind such draconian exactions from merging parties have not been critically evaluated based on the facts and circumstances of the rail industry. We find that the available evidence does not bode positively for application of forced access to rail networks. Forced access would entail greatly expanded regulatory intrusion into the workings of marketplace forces that the Staggers Act regime has properly tapped. It would require extensive regulation of industry access fees, dispatching, and investment priorities. International experience (e.g., as in Britain) with such policies for

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[7] Regarding divestiture, see, for example, IMPACT Reply Comments at 9, 23; Comments of IMC Global at 4. Regarding open access, see for example Comments of Enron Corporation at 2; Joint Comments of Subscribing Coal Shippers at 14-15.

railroads has not been encouraging, to say the least. The implications for the U.S. of calls for competition "enhancement," rather than protection, would likely be the destruction of the already marginal profitability of the industry. While understandably attractive to shippers in the short run, such exactions are not in the public's enduring interest in a healthy and efficient national transportation network.

We conclude that the Board should reject the competition enhancement standard. Calls for competition "enhancement" and forced access should be recognized for what they are: attempts to overturn the cornerstones of the highly successful Staggers Act regime. Staggers Act policies have properly recognized that railroads operate as *networks* and that it is inherently the case that an efficient railroad system does not entail a large number of rail options reaching each and every customer. Accordingly, the Staggers Act regime provides wide scope for market forces where competitive alternatives are present and for the differential pricing, limited by rate oversight in cases of rail market power, that rail networks require for long-term viability. With this regulatory framework having succeeded in restoring a basic level of health to the rail sector, it is hardly surprising that political forces are now surfacing that would sap that health. The very long-lived capital of the rail industry makes it a sitting duck for such opportunistic exactions. The durability of rail capital and concomitant low variable costs relative to overall costs mean that the industry can be attacked for financial concessions for extended periods before it deteriorates to dysfunction. Yet, history has taught us that taking this bait is short-sighted and a course that harms the public interest.

II. RAILROAD MERGERS AND THE IMPACT ON RAIL-TO-RAIL ALTERNATIVES

Many parties claim that railroad mergers (both past and future) inevitably lead to increased market power for railroads.[8] However, none of the comments submitted to the Board explains why the Board's screening process has not or will not continue to detect market power problems, or why the remedies the Board has applied in past transactions are insufficient to protect competition. None of the statements makes any effort to demonstrate railroad market power empirically.

The proponents of a "paradigm shift" to competition enhancement in merger policy are notable for repetitious recitation of the reduction in the total number of Class I railroads over the last decade or so.[9] And the thrust of many of these remarks is to assert that the only true competition is "*rail-to-rail* competition."[10] Assertions and insinuations of this form are contrary to well-recognized principles demonstrating that intermodal competition is *true* competition. But even were the reality of intermodal competition to be ignored, no party taking that position here focuses on the remaining relevant question of whether a reduction in the number of independently owned railroads has actually reduced the number of rail options available at the level of the individual shipper. After all, merging, say, Burlington Northern and the Santa Fe would not have reduced the rail options of a shipper that was otherwise solely served by the Santa Fe and certainly would not have reduced the options of a shipper reached by, say, CSX and NS. The fact is that it has always been the case that, no matter how many Class I railroads there have been, most shippers have had access to a very limited number of railroads that have been physically situated to serve them. In fact, numerous sources of evidence show that past mergers have not increased railroad market power and that, in the aggregate, shippers' rail options have actually *increased* since 1988.

II.A Class I Mergers Have Not Decreased the Number of Locations Served by More than One Railroad

We have examined two separate sources of data—Freight Station Accounting Code

[8] Comments on the Proposed Rules Submitted by the U.S. Department of Agriculture, November 17, 2000, at 5-6.

[9] IMPACT Reply Comments at 10; Comments on Notice of Proposed Rulemaking Submitted by National Industrial Transportation League ("NITL") at 5-6.

[10] Reply Comments of PPL Generation , LLC and PPL Montana, LLC at 12; Reply Comments by E.I. Dupont Nemours and Company at 2.

data and STB Carload Waybill Sample data—to determine whether mergers have reduced shippers' rail carrier options. In both cases, our analysis shows not a reduction, but an increase, in shipper options.

The AAR Railroad FSAC Master File dataset includes railroads' reported data on each station in North America including geographic location coded using 6-digit Standard Point Location Codes (SPLC).[11] The FSAC data indicate the railroads with the right to receive or deliver freight at each freight station (as indicated by the number of independent railroads reporting access to stations at the location), but do not provide data on actual shipments moved by each licensed carrier.

If recent railroad mergers had reduced shippers' competitive rail options, we would expect that the number of carriers offering service at individual locations would have declined over recent years. To test this question, we have used the FSAC data to analyze the number of carriers per U.S. location in 1994, which preceded the UP/CNW, BN/ATSF, UP/SP, Conrail, and CN/IC transactions.[12] We find that in 1994 82.4 percent of locations (defined by a 6-digit SPLC) could be served by only one railroad, and only 13.7 percent could be served by two carriers. Performing the same calculation for 2000, we find that the percentage of locations that could be served by only one carrier had declined to 74 percent, while the portion of locations that could be served by two carriers had risen to 19.1 percent. Our results, presented in Figure 1, show that the percentage of locations with more than one rail option has increased by over 45 percent since 1994. Further, the absolute number of SPLCs with two carriers increased from 3,726 (in 1994) to 4,837 (in 2000).

As another approach, we have used STB Waybill Sample data to examine the effect of mergers on rail-to-rail competition by analyzing the number of separate carriers that actually handled rail shipments to or from each shipping origin and destination location in

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11 A 6-digit SPLC roughly corresponds to a town or portion of a large city.

12 These tabulations were performed at our direction by FTI Consulting. We limited the analysis to U.S. stations and excluded Amtrak.

the U.S. in three different years (1988, 1994, and 1999).[13] We tabulated SPLC locations according to whether there were one, two, or more railroads actually handling shipments to or from that location. If recent mergers had reduced rail-to-rail competition, we would expect that the number of locations served by multiple carriers in 1988 and 1994 would be greater than in 1999.

The results of the Waybill Sample analysis are consistent with the results of the FSAC analysis. As Figure 2 shows, 86.9 percent of U.S. locations that originated or terminated rail shipments actually used only one railroad in 1999, compared with 88.9 percent in 1994, and 90.3 percent in 1988.[14] The data thus indicate that most shipping locations have had freight handled by but one railroad both before and after the mergers of the past ten years. Importantly, the data show that the percentage of SPLCs with freight handled by two railroads has actually increased between 1988 and 1999, from 7.8 percent in 1988 to 8.9 percent in 1994 to 11.1 percent in 1999. This trend reflects, for example, the introduction of trackage and haulage rights pursuant to merger proposals (as in BN/Santa Fe and UP/SP) and the creation of shared access areas (as in the case of CSX's and NS' acquisitions of the Conrail system).

In short, our analysis of both FSAC and Waybill data reveal that recent mergers have not reduced the rail options available at individual shipping locations. To the contrary, both the FSAC and the Waybill sample indicate that more locations have multiple rail options

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13 The STB Carload Waybill Sample does not allow us to identify the shipper or freight station; rather we look at originations and terminations from each six-digit SPLC. The Waybill Sample has the strength that it looks at actual shipments. When it shows two or more carriers serving a SPLC, it does so because traffic is actually moving. In certain locations, however, two railroads may serve the SPLC, but not all shippers in the SPLC may have access to both railroads. On the other hand, because it is a sample, there are likely cases in which more than one railroad ships to or from a location, but only one railroad's shipments were included in the sample. These offsetting biases are not likely to change significantly over time and are not likely to affect the pattern of change over time. Also, the Conrail transaction was implemented halfway through 1999, so Conrail was not treated as a separate serving railroad in that year.

14 If a short-line railroad originates or terminates traffic to a SPLC and the short-line's traffic to or from this SPLC is interlined only with another Class I railroad that originates or terminates traffic at that SPLC, we did not count the short-line as an independent rail option. Only if the short-line originates or terminates traffic at a SPLC and interlines some of that traffic with a Class I not otherwise shown as originating or terminating traffic at that SPLC did we count the short-line as a separate rail option. The FSAC data do not include information on short-line interconnections with Class I's.

today than they did before the recent round of mergers. According to the FSAC data, the percentage of locations with the choice of service from two or more railroads increased from 18 to 26 percent between 1994 and 2000. According to the Waybill sample statistics, the percentage of locations where shippers are using two or more railroads to originate or terminate shipments increased from 10 to 13 percent between 1988 and 1999.

II.B Analysis by the Board Shows Recent Mergers Have Not Reduced Competition

The Board's December 2000 decision in the UP/SP general oversight proceeding finds "vigorous competition...in the West."[15] Citing the Board's recent study of railroad rates,[16] the decision states that rates in the West declined 9 percent from 1996 to 1999 on an inflation-adjusted basis, and that "[r]ate decreases of this magnitude could not have been realized if the UP/SP and BNSF mergers had substantially decreased rail competition in the region."[17]

In accord with Figure 3, the Board's recent broad study of rail rates concludes:

> [W]e can state confidently that the recent mergers in the West have not reduced the downward pressure on rates. In fact, ...western rates were stable from 1992 to 1994, but resumed their decline once the restructuring of the western rail network had begun.[18]

The Board also found that rates in the East have declined, but at a somewhat slower rate since 1994 (albeit the major eastern restructuring – the CSX and NS acquisitions of Conrail's assets – was not implemented until mid-1999). Indeed, the Board's analysis (see Figure 4) found that rail rates have declined both in the east and in the west, for all commodities, from coal to food to lumber.

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15 STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 16, December 13, 2000, at 6.

16 Surface Transportation Board, "Rail Rates Continue Multi-Year Decline," December 14, 2000.

17 STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 16, December 13, 2000, at 6.

18 Surface Transportation Board, "Rail Rates Continue Multi-Year Decline," December 14, 2000, at 7.

II.C Negotiated Remedial Merger "Conditions" Can Protect Competition – The Case of BNSF Activities on UP/SP Merger-Condition Lines

Evidence from BNSF's highly successful efforts to market its services in the UP/SP merger condition corridors show that access conditions privately negotiated to protect competition in the context of a merger can be highly effective sources of rail-to-rail competition, and highly beneficial to shippers. In its recent decision in the UP/SP oversight proceeding, the Board found that "BNSF has become a strong competitor to UP where it provides service under trackage rights as a result of the merger."[19] In its January 2001 Quarterly Report in the UP/SP Oversight Proceeding, BNSF reported that it had attracted over 370,000 loaded units of traffic in 2000 (through November) on the routes to which it was granted rights as part of the UP/SP merger.[20] As shown in Figure 5, over four years, BNSF's volumes on these routes have grown from nothing to a level that would qualify that activity to be classified as another Class I railroad. Capturing such business from the UP/SP and other transportation providers is the essence of competition. These results demonstrate that the Board, indeed, has the tools – through the negotiated conditions driven by merger policy precedent – to protect competition.

II.D End-to-End Rail Mergers Have Not Created Competitive Harm and Have Enhanced the Efficiency and Competitiveness of the U.S. Transportation Sector

Given the structure of today's railroad industry, future mergers are likely to be predominantly end-to-end (vertical) in nature. As we explained in our initial statement, economic analysis indicates that end-to-end mergers are unlikely to create market power. End-to-end mergers create very few circumstances where shippers lose an existing rail option ("3-to-2" and "2-to-1" shippers). For example, analysis of the (proposed) BNSF/CN merger identified only a handful of locations representing a very small percentage of the two companies' traffic that would have gone from two to one rail carriers as a result of the

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[19] STB Finance Docket No. 32760 (Sub-No. 21), Decision No. 16, December 13, 2000, at 6.

[20] *Quarterly Progress Report of The Burlington Northern and Santa Fe Railway Company*, Finance Docket No. 32760, January 2, 2001.

merger – and, of course, Board precedent is unambiguous in that it would have compelled the merging parties to have provided remedial conditions yielding replacement service by a new second carrier. The predominant character of transcontinental mergers is inherently end-to-end.

End-to-end mergers enhance the efficiency of rail service by expanding the geographic reach of single-line service. This accords with strong market incentives for shippers to prefer the reduced transit times, reduced handling, and reduced transactions costs of multi-line rail shipment. Expansions of single-line service have improved the competitiveness of rail service and helped hold back the tide of rising truck carriage. Several parties to this proceeding, however, raise the specter of harm to competition by end-to-end, vertical mergers. They urge rejection of the so-called "one lump" analysis of the competitive effects of vertical mergers in the rail industry.[21]

The "one lump" analysis notes that there is but one lump of value that shippers are willing to pay for any given shipment. If a carrier is a sole-serving railroad at one end of a move and that carrier is a profit-maximizing business, that carrier will set its rates to garner what it can of the one lump of shippers' willingness to pay. Whether the sole-serving carrier at a relevant end point (a) is the only railroad involved in the shipment, (b) interlines with another carrier to complete the movement, or (c) merges with one of multiple other carriers that are needed to complete the move, profit-maximization leads to the conclusion that the shipper's total cost of the movement in the latter case (c) will not be higher than in either case (a) or (b). Moreover, comparing case (b) and case (c), profit maximization means that it will not be profitable for the sole-serving carrier at one end of a move to forgo using a non-affiliate railroad to complete the move when and if that railroad is a more efficient alternative. When unaffiliated carriers are not employed in the move post-merger, it is

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21 See Comments on the Notice of Proposed Rulemaking Submitted by the National Industrial Transportation League at 8; Comments of Dow Chemical Company at 11; Comments of the Committee to Improve American Coal Transportation at 27.

because it is inefficient to do so.[22]

In calling into question (yet again) these results of profit maximization by vertically linked railroads, commenters in this proceeding urge rejection of the one lump "theory" as a standard of merger analysis and treat recognition of the underlying economics as if it were an act of faith that is unjustified in reason and evidence. This view reveals misunderstanding, if not misrepresentation, of the economics and procedural nature of the analysis of the competitive implications of vertical, end-to-end joinings of railroads through merger. Complaining commenters would suggest that vertically-merging railroads cannot be trusted either to fail to harm consumers or to continue to utilize non-affiliates when efficient to do so. What these commenters appear to misunderstand (albeit, a misunderstanding not shared by the Federal Court[23]) is that this amounts to suggesting that a vertically merged carrier will not be profit maximizing in its conduct. We might just as well protest that the Board should not be concerned about market power because a merged firm which enhances its market power is unlikely to take advantage of that power to maximize its profits.

Notwithstanding the predictive power of the economics of "one lump" and vertical, end-to-end merger analysis, the actual procedures used by the Board have not entailed mere assumption of the power of these economics – as some commenters and the Notice of Proposed Rulemaking might suggest. Rather, cases such as BN/SF and CSX/NS-Conrail have entailed extensive empirical analyses, discovery, and argument in the context of each specific case.[24] This precedent is clear and means that the Board is armed with the

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22 For more complete discussion of the applicable economics, see *Western Resources, Inc. v. Surface Transportation Board*, United States Court of Appeals, Decision of March 28, 1997, at 7-21. See, also, Burlington Northern and Santa Fe Pacific, Rebuttal Verified Statement of Joseph P. Kalt, Finance Docket No. 32549, at 43-53.

23 *Western Resources, Inc. v. Surface Transportation Board*, United States Court of Appeals, Decision of March 28, 1997 at 7-21.

24 See Decision No. 38 of the Interstate Commerce Commission, Burlington Northern and Santa Fe Pacific, August 16, 1995, Finance Docket No. 32549, at 70-79; Decision No. 89 of the Surface Transportation Board, CSX Corporation and CSX Transportation and Norfolk Southern Corporation and Norfolk Southern Railway Company and Conrail Inc. and Consolidated Rail Corporation, July 20, 1998, Finance Docket No. 33388, at 52-53; Western Resources, Inc., v. STB, US Court of Appeals, No. 95-1435, Decision, March 28, 1997., at 7-21. See also Burlington Northern and Santa Fe Pacific, Rebuttal Verified

mechanisms for undertaking analytic and factual investigations of the vertical implications of end-to-end mergers in the future. The unsupportable "paradigm shift" would be to create a precedent or rebuttable presumption against the economics of profit maximization in end-to-end settings by merging railroads.

We believe what is truly at issue in the discussion of "one lump" economics and the competitive implications of vertical, end-to-end mergers is shippers' wish that they could pay less for movements, whether those movements involve single-line carriage or interline carriage. In this regard, it is telling that numerous parties would couple rejection of "one lump" economics with calls for such steps as reversal of the so-called bottleneck decision,[25] mandatory opening of all gateways,[26] revision of the *Midtec* standard,[27] and net increases in the number of carriers as the regulatory "price" of merger.[28] It is perhaps the nature of the rulemaking and regulatory process that parties will pursue their self-interest in this fashion. Of course, that is not synonymous with pursuit of sound public policy for the railroad industry.

II.E Past Mergers and Merger Policy Have Not Created Monopoly Profits for Class I Railroads

Many parties allege that recent mergers have increased railroad market power, despite the Board's vigilant protection of shippers' competitive options. Future mergers are asserted to hold inevitable harm to competition in ways that will not be detected by the Board's screening; or, if detected, prospective harm will not or cannot be remedied. These parties conclude that some form of forced access at regulated rates is necessary to counteract this market power. However, while the Board's current policies are based on a presumption that

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Statement of Joseph P. Kalt, Finance Docket No. 32549, at 43-53.

25 See Comments of the Consumers United for Rail Equity at 4-5; Comments of the Edison Electric Institute at 6-7; Joint Comments of Subscribing Coal Shippers at 16-18.

26 See Comments of Ameren Services Company at 3; Comments of the National Grain and Feed Association at 7-8; Submission of Weyerhaeuser Company at 4.

27 See Statement of the Alliance for Rail Competition at 4; Comments of the American Farm Bureau Federation at 1-2; Comments of PPG Industries Incorporated at 2.

28 Comments of PPG Industries Incorporated at 2; Comments of IMPACT at 4; Comments of Consumers United for Rail Equity at 4.

railroads possess some measure of market power, limited by rate oversight, over some captive shippers, there is no reason to believe that recent mergers have increased market power.

Recognition that railroads can have some measure of market power in serving some captive shippers,[29] and that the regulation-limited harnessing of this power can be a means of covering railroads' large fixed and common cost burden, is the basis of the differential pricing policy introduced by Congress in the Staggers Act. Differential pricing is designed to give railroads an opportunity—but no guarantee—to recover the costs of their investments. In enacting the Staggers Act, Congress correctly recognized that providing such an opportunity was the only way to reverse the disinvestment that was then endemic to the railroad industry. At the same time, the Board's pricing rules limit the railroads' exercise of market power by capping the prices they can charge captive customers. As we explained in our initial statement, this system of limited differential pricing has played a key role in the dramatic revitalization of the rail sector over the past 20 years.

Advocates of forced access at regulated tariffs imply that railroad mergers have rendered differential pricing obsolete. If mergers had increased railroads' market power, railroads would now have "too many" captive customers and differential pricing would enable the railroads to earn monopoly profits rather than merely to cover their legitimate operating and capital costs. If this were true, we would expect to see evidence that railroads are earning monopoly profits. However, no evidence has been presented in this proceeding to support a finding that any of the Class I railroad companies is a monopoly or is earning monopoly profits. To the contrary, there is ample evidence that railroads do not earn their full "cost of service" as it would be defined in other regulated industries.

The Board's own analysis indicates that railroads chronically fail to earn their required cost of capital on investment.[30] Wall Street rating services make similar conclusions in their analysis of railroad financial performance. For example, in its rating

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[29] E.g., where a rail-captive shipper is not protected by intermodal alternatives.

[30] Verified Statement of Bradford Cornell, Ex Parte No. 582 (Sub-No.1) at 7-8.

outlook for the railroad sector, Moody's Investors Service reports that railroad sector cash flow was sufficient to meet interest payments but insufficient to adequately compensate equity investors. Moody's opines that railroads' failure to earn their cost of capital may lead to disinvestment:

> In general, those operators who are unable to generate a return from operations to satisfy the equity as well as the debt providers are at increasing risk for financial transactions that could increase the risk of the debt holders. Companies are likely to seek to return capital to shareholders via financial strategies that can increase the risk to debt holders, such as share repurchases or increased dividends.[31]

In addition, financial performance measures prepared by independent analysts show that railroads' performance regularly lags that of most industrial sectors. Each year *Fortune* magazine compares return on assets (ROA) and return on equity (ROE) for groups of large companies arranged by industry sectors. Since *Fortune* began including a railroad group in this analysis (1993), the railroad group has consistently performed significantly worse than the median industry group. (See Figures 6 and 7.) In 1999, *Fortune* ranked the railroad group as 34th and 37th for ROA and ROE, respectively, out of 41 industry groups.

II.F Railroad Mergers Need Not Harm Product and Geographic Competition

Some parties claim that past mergers have significantly reduced product and geographic competition, and that future mergers will unavoidably damage such competition in ways that either cannot be detected during the merger review process or, if detected, cannot be remedied.[32]

As we said in our initial statement, future mergers are unlikely to pose serious threats to geographic competition because the factors that contribute to the loss of geographic

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[31] Moody's Investors Service, *Railroad: Industry Outlook*, December 1999, p. 9. In the same vein, Credit Suisse First Boston says of Kansas City Southern: "As is the case with all the railroads, the current stock price implies that the company will never earn its cost of capital." CSFB Equity Research, December 21, 2000.

[32] Comments of NITL at 7-9.

competition are even less likely to be present in future mergers than they were in the past.[33] Several of the major mergers in the 1990s, while predominantly end-to-end, at least involved railroads operating in the same broad geographic areas, such as the BN/SF, the UP/SP, and the Conrail transactions. By contrast, in a proposed merger of one of the western and eastern railroads, the railroads would not for the most part serve the same regions for most of the traffic.

In addition, there is no reason to believe that potential reductions in product and geographic competition cannot be identified and mitigated in the same ways that potential reductions in multiple railroad access have been dealt with in the past. Potential losses in product and geographic competition have been raised in previous rail mergers, and the steps for assessing those losses are relatively straightforward. Similarly, the steps to mitigate any threatened reduction in product and geographic competition are equally straightforward. The merger applicants would be expected to offer trackage rights or similar remedies to preserve product and geographic competition, much as they have been expected to offer trackage rights to preserve shipper access to multiple railroads. And if the applicants did not volunteer a satisfactory remedy, the Board would be free to impose a remedy as a condition for the approval of the merger.

III. FORCED OPEN ACCESS AT REGULATED RATES IS POOR PUBLIC POLICY FOR THE U.S. RAILROAD INDUSTRY

As we pointed out in our initial comments, the vagueness of the Board's competition enhancement rule is an invitation for intervenors to hold up merger applicants and to demand special concessions – groundless or otherwise – as conditions for agreeing not to oppose the merger. While the Notice here does not define what measures would satisfy a competition enhancement standard, or how it would be determined that competition has been enhanced enough to satisfy such a new standard, the comments the Board has received show the fervor with which many shippers will object to any merger that does not result in substantial

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[33] V.S. of Jose A. Gomez-Ibanez and Joseph P. Kalt at 15-17.

portions of rail networks being subject to forced open access at regulated rates. Shippers have demonstrated their willingness to demand forced access even to lines that are not obviously affected by the merger—and even to the lines of railroads not involved in the merger. Enactment of a competition enhancement rule would substantially increase the portion of rail networks subject to forced access at regulated rates subsequent to any future merger.

III.A Forced Open Access Does Not Promise to Make the Railroad Sector More Efficient

Discussion about whether or not to impose forced open access in the context of merger policy begs the question of whether forced open access would be good policy for the rail sector. Should railroads be unbundled, with track owners required to make their facilities open to multiple operators of trains? Of course, some parties will always reap private benefits from policy changes that enable them to avoid paying for the sunk costs of the network. From a public policy perspective, what matters is not whether some network customers will benefit from transfers of wealth but whether or not open access is likely to generate real benefits for society by increasing efficiency. Answering this question requires careful consideration of the economics of rail networks.

Some parties have suggested that unbundling and open access policies for electricity and natural gas networks provide a good model for rail networks.[34] However, reasoning by analogy to other sectors quickly runs into key attributes that distinguish railroads from other networks.[35] First, railroad shipments must be routed between specific origin and destination pairs. This contrasts with electricity networks, in which customers only care about the quantity of electricity they receive and not which specific generator produced it. The fact

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[34] Reply Comments of PPL Generation, LLC and PPL Montana, LLC at 7.

[35] For a fuller discussion of these issues, see Jose A. Gomez-Ibanez, "Regulating Coordination: The Promise and Problems of Vertically Unbundling Private Infrastructure," Discussion paper, Taubman Center for State and Local Government, Kennedy School of government, Harvard University, December 1999; and by Amy Bertin Candell and Joseph P. Kalt, "Open Access for Railroads? Implications for a Non-Hub, Congestible Network Industry," Advanced Workshop in Regulation and Competition, 19th Annual Conference, Lake George, New York, May 2000.

that the units of electricity flows are not address-specific in their origins or destinations gives a system operator more flexibility in the use of scarce transmission capacity than a railroad has. Second, and perhaps even more important, railroad flows are made up of heterogeneous goods and commodities. This makes it harder to define network capacity or investment needs. A railroad line often serves both fast and slow trains, for example, and each has its specific infrastructure needs. Super-elevated curves may be desirable for a fast passenger or container train, for example, but create track and wheel wear problems when used by bulk freight trains with heavy axles. In electricity and gas, by contrast, the units moving through the network have nearly identical physical characteristics, making it easier both to design the appropriate network and to define the network's capacity. These differences complicate the task of arriving at pricing regimes for unintegrated infrastructure owners, since policies of unbundling and access do not remove the problems of allocating scarce rail capacity and ensuring the sustainability of infrastructure facilities and investment. Indeed, evidence from contexts in which railroads have opportunities and incentives to choose the efficient organizational form—market or integrated firm—indicates that the preponderance of forces has been pushing coordination inside the firm as the efficient response.

In sum, unbundling and open access in the rail sector is unlikely to enhance efficiency. While implementing open access in any network industry is a costly undertaking, for the reasons discussed above such a policy in the rail sector would present coordination problems that would raise transactions costs and require intensive regulatory involvement. Owing to the particular nature of rail networks, these problems and costs are significantly different from what regulators of other network industries have had to deal with, and other networks are thus poor analogues for the rail network. Thus, any consideration of mandatory open access properly should entail a thorough *rail* industry-wide analysis and rulemaking, and it certainly would be unwise to use merger policy and individual merger proceedings to introduce mandatory open access.

In any investigation of forced access, it is important to pay careful attention to defining the public benefits that might be hoped for under forced access. In theory, despite high costs of implementation and administration, forced access in some industries might nevertheless be beneficial on net if it enables the achievement of otherwise unavailable efficiencies. For example, policymakers estimated that introducing competition into the electric generation market (generation-related costs typically account for 75% of a customer's electric bill[36]) and forced access to transmission lines for generators could save $3.8 to $5.4 billion per year when compared to the costs that were expected to result from continued regulated franchise monopoly control.[37] The promise of such savings was judged to justify the enormous cost of the transition to a forced access model. Of course, recent events (including shortages of supply and distorted price signals) in California and other regions have policymakers in many jurisdictions re-thinking this judgment. Notably, none of the statements the Board has received in this proceeding makes a credible effort to demonstrate factually that forced access in the *rail* sector would increase efficiency.

III.B Forced Access Would Most Likely Require Substantial Re-Regulation of Rail Rates

A policy of forced open access would require pervasive rate regulation by the Board. Indeed, the parties calling for forced access are explicit in their insistence that the Board regulate rates. These parties' statements are quite clear on the fact that it is not access *per se*, but access at prices determined and set directly by the Board's regulatory authority, that they desire.[38] Beyond the system of differential pricing and rate limits in market dominance settings under the Staggers Act, extensive and detailed regulation of railroad rates would not be in the public interest. Prices set by regulators commonly distort price signals to producers, investors, and consumers. Concomitant results range from inefficiencies in the

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[36] U.S. Energy Information Administration *Electricity Prices in a Competitive Environment*, August 18, 1997, Chapter 2.

[37] U.S. Federal Energy Regulatory Commission, Order No. 888, April 24, 1996 at 3. FERC found that "it became increasingly clear that the potential benefits that could be derived from these technological advances could be realized only if more efficient generating plants could obtain access to the regional transmission grids" and that "barriers continued to exist to cheaper, more efficient generation sources". (FERC Order No. 888 at 29)

[38] Comments of National Grain and Feed Association in Response to Notice of Proposed Rulemaking at 7-8; Submission of Weyerhaeuser Company at 3-4.

level and use of resources to disruptions and shortages.

The ongoing debacle in the California electricity sector provides a high profile example of shortages that occur when price regulation shields consumers from paying market prices and distorts suppliers incentives to meet consumers' needs.[39] Similarly, as we discuss below, experience with forced rail access in the U.K. provides a telling illustration of how prices set by a regulator fail to balance supply and demand and require further (and burgeoning) regulatory intervention to allocate resources. There is no reason to believe that pervasive, detailed regulation of railroad rates is likely to produce better outcomes than was the case when it was abandoned 20 years ago. The railroad industry and its customers have been down this road before and it has led to disinvestment and massive inefficiencies.

Advocates of forced access policies are prone to characterize such policies as leading to a reduction in regulation.[40] To the contrary, the experience of open access policy in other network industries is that it tends to substantially *increase* regulatory burdens because it requires new rules about pricing and other terms and conditions for use of the network, and because it increases the number of disputes for which parties have a forum to request regulatory intervention. The Board is singularly ill-prepared to implement such regulation because it lacks the staff and procedures that other agencies have had to maintain and/or build in such cases. Unlike traditional "utility-style" regulatory agencies (e.g., the FERC), the Board does not directly regulate rates under public utility principles and does not have the concomitant legal obligation to guarantee railroads an opportunity to recover their costs of service. Rather, Staggers Act policy provides wide scope for individual contract negotiation between willing parties, with market dominance and revenue adequacy limitations of rate levels.

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39 Demand growth and shortages of generation capacity were the proximate causes of shortages and price spikes in the wholesale market, but regulatory caps on the prices paid by end-users prevented a demand response to the high prices. See Frank A. Wolak, Robert Nordhaus, and Carl Shapiro, "An Analysis of the June 2000 Price Spikes in the California ISO's Energy and Ancillary Services Market," September 6, 2000.

40 Joint Statement of Shell Oil Company and Shell Chemical Company at 12.

The expectation that forced access would increase regulatory burdens in the rail sector is not speculative. Instead, there is ample evidence from other network industries that the introduction of forced open access can take many years, many regulatory dockets, and intensive ongoing regulatory oversight. The FERC's efforts to restructure the electricity industry are a case in point. As shown in Figure 8, the workload at the Electric Power Division of the FERC has increased dramatically since the agency "deregulated" and issued its proposed rulemaking on open access transmission tariffs in 1994.[41] FERC's workload, staffing levels, and budget for its electricity jurisdiction have grown dramatically and show no indication of returning to their previous levels.

In the rail context, the impetus for greatly expanded regulatory intervention arises because, when a rail carrier is forced to compete with other carriers for traffic on its own lines, the regulator must establish (and enforce) rules about how potentially scarce capacity will be priced and allocated. As in other sectors, this inherently would entail concerns that the host carrier might have both incentives and opportunities to tilt the playing field in its own favor. Inevitably, there would follow disputes over operational decisions that the network operator must make in real time. For instance, the network operator may sometimes take actions that appear to favor its own movements at the cost of delaying competitors' movements. How is the Board to know whether such decisions were based on sound operating practice or on improper preference? Such problems have arisen from time to time in the trackage rights agreements of various mergers and these disputes have sometimes required litigation. Experience indicates that forced access would surely increase the number and magnitude of such disputes. Indeed, such problems in other open access networks have pushed regulators to move beyond rate and allocation regulation into highly detailed and

41 FERC issued its policy statement regarding Regional Transmission Groups (RTG) in July 1993. FERC hoped that RTGs would encourage negotiated agreements between transmission providers and avoid time-consuming and expensive litigation of terms and conditions for transmission access. Finding that discriminatory practices persisted, FERC issued Order No. 888 in 1996, requiring all transmission providers to file open access non-discriminatory transmission tariffs and providing for utilities to recover stranded costs associated with open access. U.S. Energy Information Administration *The Changing Structure of the Electric Power Industry 2000: An Update, October 2000*, pp. 33, 62-64.

frequently litigated regulatory codes of conduct to prevent discrimination by network operators.

Forced access policies also inevitably affect a network operator's incentives to invest in system augmentation. The identification of new investments, as well as the allocation of their costs and benefits, become issues for regulatory decision-making rather than market judgments made by network operators risking their own capital. Network operators evaluate proposed projects on the basis of expectations about regulatory treatment of costs in setting tariffs rather than the market value of the capacity. The difficulty of designing regulatory policy capable of enabling efficient levels of private investment in network assets in the context of forced access is illustrated by the dramatic decline in electricity transmission system investment since the FERC's open access transmission rule:

> The NOPR [Notice of Proposed Rulemaking] pointed to a noticeable decline in planned transmission investments and expressed concern that, without a regional approach to planning and expansion, it would be difficult to address complex and controversial issues that arise when the benefits of an expansion do not necessarily accrue to the transmission system that must undertake the expansion.[42]

Experience with forced access in the U.K. rail sector (described below) provides the example of a rail regulatory agency similarly struggling (so far unsuccessfully) to make rules that will attract private investment in the network.

III.C Competition Enhancement/Forced Access Would Be Likely to Further Harm Incentives to Invest in Railroad Assets

It seems likely that a policy of forced access at regulated rates would harm the (already weak) financial performance of railroad assets. Forced access would require the Board to establish tariffs for railroad networks, presumably at rates lower than the railroad

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[42] U.S. Federal Energy Regulatory Commission Order No. 2000, December 20, 1999, at 34. The FERC also found that: "The amount of new transmission capacity planned over the next ten years is significantly lower than the additions that had been planned five years ago, and most of the planned projects are for local system support." (at 18)

would have charged in a market-based arrangement—otherwise, there is no need to force the access. The net effect of any such rate regulation is clear—railroad revenues would decline and shippers would be enriched by an equal amount. The cost of this transfer would most likely be paid by railroad shareholders in the form of reduced asset and equity values.

The primary beneficiaries of this transfer would be the largest shippers. While railroads serve thousands of shippers, the bulk of railroad revenues derive from serving a relative handful of shippers. For example, in 1999 BNSF served 8,896 shippers; 500 of these shippers accounted for about 89 percent of BNSF's revenues, and the top 100 shippers accounted for about 62 percent of BNSF revenues. A wealth transfer from railroad shareholders to the shareholders of these other large companies is not synonymous with promotion of the public interest. Indeed, it was the objective of preventing inequitable and distorting transfers of this form that compelled the FERC (and virtually all state regulatory commissions) to make stranded cost recovery by regulated utilities a cornerstone of open access policies in the natural gas pipeline and electricity transmission and distribution sectors.

Above all, the Board should be especially concerned about the effect forced access policy might have on railroads' incentives to invest in the maintenance and augmentation of their systems. Railroads are of course one of the most capital-intensive industries and increased private investment is one of the major themes of the Staggers Act success story. If railroads are forced to face even greater obstacles in their efforts to recover the costs of their investments, railroad managers will not be able to justify continuing today's high level of capital investment. The Board and the public should be especially wary of policies that threaten to trigger disinvestment in the rail sector.[43]

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[43] Subsequent to the Board's announced moratorium on mergers, BNSF CEO Robert Krebs announced that BNSF was canceling several major investments that would have enhanced the capacity of the company's network, and would henceforth make only those investments necessary to maintain the system at its current levels. "Moratorium Puts Burlington Northern Plans Off Track: Blocked Deal with Canadian National Forces Railroad to Rethink Its Growth," *Washington Post* October 11, 2000, p. E-2.

III.D The British Experience with Open Access

The kinds of difficulties expected under open access to railroad networks are illustrated by the experience of Britain, the country with the most extensive experience with open access.[44] The U.S. and British railway systems differ in important ways. For example, the British system is predominantly a passenger railway with freight playing a more minor role, while in the United States the situation is reversed. Nevertheless, whether moving people or freight, the operation of rail networks entails substantial challenges of logistical coordination, maintenance of investment incentives, establishment of operational priorities, and compensation for service. The British experience provides valuable insights into the handling of such challenges in a regime of forced open access.

When Britain privatized British Rail in 1994, it divided the national railway into approximately 70 separate companies, the most important being Railtrack, 25 passenger train operating companies (nicknamed TOCs), and 2 freight TOCs.[45] Railtrack owns and operates the track, station, yards, and other infrastructure and is financially dependent on track and station access fees it charges the TOCs. Since Railtrack is a monopoly, the charges are regulated by the Office of the Rail Regulator (ORR).[46] Under the British system of price-cap regulation, ORR reviews access charges every five years. In the years between the reviews, access charges are allowed to increase by the rate of inflation less Railtrack's expected rate of productivity improvement. Despite efforts by the government to implement a relatively light-handed regulatory regime of price caps and private negotiations, there have been enormous controversies over Railtrack's access fees, and particularly whether they provide the right incentives for Railtrack to invest in capacity and safety. The result has been a cascading imposition of increasing and vacillating regulation.

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44 Sweden has had an open access system for longer, but the infrastructure company and the main train operating company are both publicly owned and there are very limited private train operations.

45 The government auctioned off seven freight TOCs, but one company bought six and consolidated them into one. Besides Railtrack and the TOCs, the other companies created and sold off include firms that lease rolling stock leasing to the TOCs and firms that maintain equipment and track for the TOCs and Railtrack.

46 Strictly speaking, the industry is regulated by the Rail Regulator, an individual, and the ORR refers to the Regulator's staff. For simplicity's sake, we use the ORR to refer to the Regulator and his staff.

A central problem in the British case has been the establishment of an appropriate structure for the access fees, and particularly determination of the proper ratio of fixed to variable charges. In its first periodic review, conducted in 1995, ORR established access fees for the passenger TOCs' base schedules that did not vary substantially with train mileage, on the theory that there was relatively little wear and tear or congestion associated with added traffic. On average, 92 percent of the access fee revenues came from the fixed annual charge each TOC paid and only 8 percent from charges that varied with the number of trains it operated. The TOCs could request additional train paths beyond those provided in their base schedule, but they had to negotiate the fees for those additional paths with Railtrack. The idea was that negotiation would allow Railtrack and the TOCs to work out case-specific capacity problems. The ORR would also review each deal, however, to make sure that Railtrack was not abusing its monopoly position in the negotiations.

Not surprisingly, this access charge scheme stimulated the TOCs to expand their services, thereby greatly increasing congestion on the network and causing serious conflicts among the TOCs, Railtrack, and the ORR. The TOCs thought the fees for new paths should be the variable portion of the standard access fee. Railtrack had little incentive to grant new paths at that low price, however, if only because the growing congestion on the network made it more vulnerable to penalties when trains were delayed.[47] ORR often had to intervene to force Railtrack to grant a path at a reasonable cost. ORR's original charge structure assumed that there was excess capacity on the network, but it rapidly encouraged an increase in train services that absorbed any excess that might have been present.

A second and closely related problem has been how to establish incentives to invest in expanding or enhancing network capacity. The ORR expected that the TOCs would ask Railtrack to invest in improvements to its network by, for example, eliminating a track bottleneck that constrained their schedules or providing better signaling to allow increased speeds. Because the regulated base access charges provided few incentives for Railtrack to

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[47] There is an elaborate penalty scheme that assess fines if a track and station is not available when promised. The fine is assessed to Railtrack or a TOC depending on who is held responsible.

invest in improvements, ORR had to provide that the TOCs and Railtrack be able to negotiate for added fees to pay for improvements, with ORR then serving as a court of appeal or review when the parties could not agree.

The resulting negotiations were so difficult that they discouraged most new investments. Railtrack and the TOCs routinely disagreed over the costs of proposed improvements. Worse, many lines were shared by several different TOCs providing different types of services, often including slow-moving and heavy coal trains, medium-speed container services, faster commuter trains, and high-speed intercity expresses. As a result, the TOCs often disagreed with one another over what investments were of highest priority and how the responsibility for costs should be apportioned among them. On one major corridor which was in obvious need of major rehabilitation, negotiations dragged on for two years before the ORR, in frustration, ordered the work to begin even in the absence of an agreement.[48] Even smaller projects involving fewer TOCs were discouraged because the negotiation costs were still disproportionate to the benefits that might be realized.

The capacity problems intensified after two major railway accidents in 1999 and 2000 raised safety concerns. The 1999 accident, which killed 31 people, was eventually attributed to a combination of a poorly placed signal and the lack of Automatic Train Protection (ATP) in a heavily traveled corridor.[49] The 2000 accident, in which 4 persons died, was attributed to a broken rail in a corridor where Railtrack had fallen behind in its rail replacement program.[50] The second accident especially raised the question of whether Railtrack had adequate incentives to maintain its system. Congestion and popular dissatisfaction increased further after safety officials also imposed slow orders on the entire railway system until

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48 This is the West Coast Main Line; for an account of the difficulties see Jose A. Gomez-Ibanez, "Regulating Coordination: The Promise and Problems of Vertical Unbundling in Infrastructure Industries," Discussion Paper, Taubman Center for State and Local Government, Harvard University, pp. 37-43.

49 In addition, driver error was suspected. United Kingdom, Health and Safety Executive, *Train Accident at Ladbroke Grove Junction, 5 October 1999: Third HSE Interim Report*, April 14, 2000 (at www://www.hse.gov.uk/railway/paddrail/interim3.htm).

50 United Kingdom, Health and Safety Executive, *Train Derailment at Hatfield, 17 October 2000: First HSE Interim Report*, October 20, 2000 (at www://www.hse.gov.uk/railway/hatfield/interim1.htm).

inspections for similar broken rails could be completed.

The ORR addressed some of the concerns about access fees in its second periodic access charge review, completed in late 2000, but the remedies seem destined to create as many problems as they solve. The ORR's major change was to establish a regulated "capacity charge" to replace the individually negotiated fees for new paths within the existing network.[51] The capacity charge is calculated by a formula set out by the ORR that varies by the route, by 12 different time periods during the week, and by the difference between the speed of the proposed and the existing services. ORR hopes the capacity charge will increase Railtrack's incentives to find paths and will reduce the burden of negotiations. However, the inevitable simplifications in ORR's new charging formula are bound to create conflicts among the TOCs, Railtrack, and the ORR.

An even more dramatic change has been the government's decision to essentially strip Railtrack and the TOCs of most of the control over investments in the network. From now on, the Strategic Rail Authority (SRA), the government agency which provides the public subsidies to the passenger TOC franchisees, will decide directly on most of the improvements the rail system needs and pay for them with grants to Railtrack.[52] Of the £8.2 billion the ORR expects Railtrack to invest in improvements over the next control period, £4.7 billion will be dictated directly by the SRA, roughly £1.5 billion have been selected by ORR (the majority for train protection systems), and most of the remaining £2 billion apparently represents expenditures for the few projects finally negotiated under the old regime.[53]

In short, the British open access system has evolved rapidly from a scheme that

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51 Although the capacity charge is the most important reform for our purposes, the ORR made several other related changes, including a new volume incentive. See Office of the Rail Regulator, *The Periodic Review of Railtrack's Access Charges: Final Conclusions*, October 2000, especially vol. 1, pp. 77-92 and Appendices F, O and P.

52 Subsidies were previously administered by the Office of Passenger Rail Franchises (OPRAF).

53 Most of the £2 billion is apparently for the West Coast Main Line modernization program and a few other schemes. See Office of the Rail Regulator, *The Periodic Review of Railtrack's Access Charges: Final Conclusions*, vol. 1, pp. 10-11 and 54-56; and Paul Waugh, "Ministers Will Strip Railtrack of Control Over investment", *The Independent*, December 18, 2000.

emphasized private initiative and decentralized decision-making to one of tight government regulation and supervision, and now government subsidy and control of investment. Fees for new paths and new investments were supposed to be negotiated, with the regulator only stepping in to resolve the occasional dispute. In theory, these negotiations would allow the TOCs and Railtrack to craft specific solutions to complex and varied network problems. In practice, however, the negotiations were often so complex and burdensome that the regulator had to dictate solutions. The latest scheme recognizes this reality by having the ORR set fees for all paths and the SRA and ORR dictate most new investment projects. But the danger, of course, is that these government agencies will never understand railroad costs and needs as well as the railroad operators themselves, and thus that money will be wasted and opportunities lost. All in all, the attempt at open access to railroad tracks has turned out to be a story of ever-increasing layers of stopgap regulation, as each policy move has led to new problems and pressures for regulators.

IV. GENERATING AND ENSURING THE BENEFITS OF MERGERS

IV.A Merger v. Non-Merger Benefits

Our initial statement in this proceeding noted that rail mergers have played a significant role in enhancing the performance of the nation's rail system over the last two decades. Reductions in interlining, the removal of redundant capacity, and investment in system integration have begun to truly modernize rail transportation to the benefit of an internationally integrated and competitive economy. Moreover, we provided clear empirical evidence that, by bringing integration and coordination decisions within the scope and common objectives of a single business firm, mergers yield efficiencies and service improvements for shippers that non-merger alternatives such as joint marketing arrangements and strategic alliances do not. The particularly clear illustration of this is the experience of the joining of BN and the Santa Fe, which has produced a burst of traffic that pre-merger alliances simply could not generate. We reiterate the data from our initial statement in Figure 9.

The UP, in particular, in its reply comments has suggested that non-merger alternatives should be presumed to be adequate substitutes for mergers when it comes to assessing the benefits of mergers, suggesting that current Board policy is not vigilant in requiring the demonstration that benefits are, indeed, merger-related when considering merger approval. This is hardly the case. Prior procedures have devoted extensive effort and analysis to examination of *net* benefits of the merger alternative. Indeed, in the case of the BNSF transaction, for example, the post-merger improvements in service have dramatically exceeded pre-merger expectations.

Of course, the fact that post-merger results *under any merger approval regime* cannot be guaranteed to match or exceed pre-merger expectations does not (as UP's comments would imply) mean that the Board must defer to the applicants' managements in deciding that mergers are the preferred way to advance the public interest, and that current Board practice is inconsistent with merger standards employed in unregulated industries by DOJ and the FTC.[54] The underlying economics that UP and others miss is that, given the current standards of the Board under which precedent clearly dictates that merger applicants condition their proposals on remedial measures (such as trackage rights) when competition might otherwise be harmed, *then* it is proper public policy to recognize that merging parties have eminently forceful private incentives to maximize the efficiencies and service improvements of the post-merger firm.

The FTC/DOJ prefer structural methods (e.g., divestiture) for remedying the anticompetitive effects of mergers, when such remedies are available. Such remedies are generally inapplicable to network contexts – divestiture is destructive of networks. And DOJ/FTC actions are consistent with this, recognizing that where no structural remedy is feasible, but a merger nevertheless problematically increases market concentration, it is proper to consider whether the merger can create benefits (i.e., gains in efficiency) that will offset the increase in market power associated with the increased concentration. The Merger

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[54] See Union Pacific's Reply Comments on Proposed Merger Rules at 19-21.

Guidelines are explicit that the purpose of benefit quantification is to offset competitive harm:

> To make the requisite determination, the Agency considers whether cognizable efficiencies likely would be sufficient to reverse the merger's potential to harm consumers in the relevant market, e.g., by preventing price increases in that market.... The greater the potential adverse competitive effect of a merger...the greater must be cognizable efficiencies in order for the Agency to conclude that the merger will not have an anticompetitive effect in the relevant market. When the potential adverse competitive effect of a merger is likely to be particularly large, extraordinarily great cognizable efficiencies would be necessary to prevent the merger from being anticompetitive. (U.S. Department of Justice and the Federal Trade Commission, Horizontal Merger Guidelines, Section 4)

At the same time, DOJ/FTC also note that "[e]fficiencies are difficult to verify and quantify" and that "efficiencies projected reasonably and in good faith by the merging firms may not be realized."

The Board, by contrast, has tools at its disposal that enable it to go beyond its net benefits quantification as a means of offsetting the competitive harms of railroad mergers. As all recent merger cases have demonstrated, the Board is well armed with precedents that compel applicants to employ trackage rights, haulage, and other remedies to ensure that mergers do not create harm to pre-merger competition. In this regard, the Board is even better equipped than the DOJ or FTC to deal with merger-related threats to competition.

The analytical process of merger reviews at the FTC/DOJ begins by first identifying merger-related competitive harms. If there are no such harms, the process ends with no challenge to the merger by the FTC/DOJ. If prospective harms are identified, the FTC/DOJ assess whether they can be mitigated by conditions that sustain the degree of competition to its pre-merger *status quo*. If so, and if the parties accept such effective conditions, then again the FTC/DOJ review process terminates. It is only if prospective competitive harms are asserted and these cannot be cured by remedial conditions that the FTC/DOJ process requires turning attention to merger benefits. The focus is then only on whether merger-related efficiencies are so great that consumers would be better off on the whole with the merger than without it, despite the unmitigated competitive harm. In making that determination, the FTC/DOJ naturally ask whether the costs of the merger – the unremedied competitive harms – are really necessary to achieve the merger benefits, or whether some less restrictive alternative, such as a non-merger alliance, would achieve the same public benefits at less cost to competition. The "skeptical" analysis of merger-relatedness thus arises only when irremediable competitive harms are determined.

Were the Board to adopt the same approach – one in which applicants need not attempt to demonstrate merger benefits at all unless and until some specific, yet irremediable, competitive harm has been identified – then it might make sense to ask questions regarding the merger-relatedness of proffered benefits at the end of the analysis. To the extent that UP's comments suggest, however, that the Board should begin with an up-front inquiry into merger benefits, dismissing some or all claimed benefits on the basis of speculation about non-merger means of achieving the same benefits, and then potentially reject merger applications on the basis of that speculation without the need to first find irremediable competitive harm, it is suggesting an exercise that is not consistent with common procedure at the antitrust agencies. Even more fundamentally, such an approach would amount to an unjustified rejection of the sound public policy principle which recognizes that it is eminently appropriate to rely on the disciplining forces of the marketplace rather than regulation when the regulator has already determined that a merger (conditioned as necessary) does not threaten to adversely affect competition.

IV.B Post-Merger Ratepayer "Protections"

EEI cites the FERC's Merger Policy Statement as support for its plea that the Board impose "ratepayer protections" as a condition for merger approval.[55] For example, EEI notes that merging electric companies sometimes commit to refrain from requesting a rate increase for a period of five years after the merger. EEI's policy recommendations make no sense in the railroad industry because railroads do not charge cost-plus regulated rates, and railroad

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[55] Reply Statement of EEI at 5-7.

mergers thus do not present the same economic problems that cost-plus rate regulation creates in electric utility mergers.

As franchise monopolies, electric utilities have a legal right to "rate relief" when their current rates do not fully compensate them for their cost of service. From an economic perspective, this right to "rate relief" creates special problems for merger policy. First, if the acquiring company is able to place into rate base any acquisition premium it pays for the acquired company (i.e., any cost above the net book value of the acquired company), then under certain circumstances[56] the company has a perverse incentive to overpay. Second, the right to rate relief creates a moral hazard problem that could lead the regulated company to inefficiently discount the risk that a merger might increase costs. Both of these economic problems derive directly from the cost-plus nature of utility rates, and cause the utility's ratepayers to bear an inappropriate share of the risk that a merger might not have net benefits. Consistent with this logic, FERC has found that its review of the rate impacts of a merger remains relevant in part because electric utilities continue to charge regulated rates and recover stranded costs through regulated mechanisms.[57]

In the past, FERC's utility principles were employed to prevent higher costs post-merger from being passed on to customers at the next utility rate case. However, finding that "these hearings have often been time-consuming, and there has been considerable controversy over whether the estimates of future costs and benefits are truly meaningful," the FERC in recent cases has found it more efficacious to rely on merger applicants' commitment to freeze rates for some period of time after the merger. FERC's policy in effect requires electric utilities to forego their right to rate relief—a right that railroads have not had in 20 years—to shift risk properly to the utility shareholders. Railroads' shareholders already face both the Board's precedents dictating the conditioning of mergers on remedial competition-protecting provisions and the obvious post-merger marketplace

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56 Regulated companies have an incentive to pad the rate base when the regulated company's actual cost of capital is lower than the cost of capital awarded by the regulator. Harvey Averch and Leland Johnson, "Behavior of the Firm Under Regulatory Constraint," *American Economic Review*, 1962.

57 U. S. FERC Order No. 592 at 37.

risks of poor performance that cannot be bailed out at the "next rate case" — as UP/SP's financial punishment *by the marketplace* in the wake of its merger so forcefully demonstrates.

IV.C The Benefits of Future End-To-End Mergers

In our initial statement, we explained that increased availability of single-line service is a primary source of benefits from end-to-end mergers. In its reply statement, IMPACT (and others) claim that end-to-end mergers "have little opportunity to reduce interchange costs: A transcontinental merger can only eliminate interchanges on a small fraction of rail traffic that moves transcontinentally."[58] IMPACT concludes that "there is no reason to think that future Class I railroad mergers will do much to improve efficiency or generate any other public benefits." IMPACT's conclusion is wrong for two reasons.

First, IMPACT's statement implies that the elimination of interchanges is the only benefit of end-to-end mergers. To the contrary, end-to-end mergers provide other significant sources of benefit that the Board has recognized in past merger reviews. While increased single-line service is certainly a major source of benefits, end-to-end mergers also create efficiencies through reducing overhead and operating costs and improving customer service. Even if IMPACT were correct in asserting that future mergers will not enable an expansion of single-line service (and IMPACT is not correct, as shown below), future mergers can provide substantial net benefits from other sources. These net benefits can be assessed by the Board in its review of the facts of a specific merger proposal—there is no need for the Board to speculate about these benefits in the present proceeding.

Second, IMPACT is wrong in its presumption that future end-to-end mergers will not reduce interlining. To test IMPACT's claim that future mergers would eliminate interchanges on only a small fraction of rail traffic that moves transcontinentally, we analyzed 1999 waybill data to see, on a pro forma basis, how much transcontinental traffic (defined as traffic moved from one side of the Mississippi River to the other, excluding those

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[58] Reply Comments of the Committee to Improve American Coal Transportation at 30.

states contiguous to the river) that was interlined in 1999 would have been moved single-line in the case of hypothetical transcontinental mergers. In order to account for the Conrail transaction, we restricted our analysis to June to December of 1999. Our results, presented in Figure 10, show that IMPACT is wrong to presume that future end-to-end mergers will not increase single-line service opportunities. For example, approximately 13 percent of 1999 transcontinental traffic (84,448 units out of 626,604 total units moved transcontinentally between June and December) would have moved single-line instead of interline in the case of a hypothetical BNSF-NS merger. This pro forma analysis certainly understates the increase in single-line traffic that such end-to-end mergers would produce, because it does not account for the ability of the merged railroad to attract new traffic by lowering costs and offering better service.[59] This is the impact so clearly demonstrated by Figure 9.

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[59] See our discussion of BNSF's post-merger success in increasing traffic in our initial statement at 26-27.

Attachment 1

José A. Gómez-Ibáñez

José A. Gómez-Ibáñez is the Derek C. Bok Professor of Public Policy and Urban Planning at Harvard University, where he holds a joint appointment at the John F. Kennedy School of Government and the Graduate School of Design. He teaches courses in economics, policy analysis, infrastructure and transportation policy in both schools.

Professor Gómez-Ibáñez has published numerous articles on transportation policy and regulation and is co-author of several books including *Essays in Transportation Economics and Policy: A Handbook in Honor of John R. Meyer* (with William Tye and Clifford Winston; Brookings, 1999); *Going Private: The International Experience with Transport Privatization* (with John R. Meyer; Brookings, 1993); *Regulation for Revenue: The Political Economy of Land Use Exactions* (with Alan Altshuler; Brookings, 1993); *Autos, Transit and Cities* (with John R. Meyer; Harvard, 1981); and *Cases in Microeconomics* (with Joseph Kalt; Prentice-Hall, 1990).

At the University, Gómez-Ibáñez currently serves as the faculty chair of the Masters in Urban Planning Program at the Design School and the faculty co-chair (with Henry Lee) of the Infrastructure in a Market Economy executive program at the Kennedy School. In the past he has served as the chairman of the Masters in Public Policy program at the Kennedy School, and as Chair of the Department of Urban Planning and Design and of doctoral programs at the Graduate School of Design.

In addition, Professor Gómez-Ibáñez has served as a consultant and advisor on transportation policy and regulation issues to government agencies both here and abroad. He served as senior staff economist to the President's Council of Economic Advisors (1980-81), where he was responsible for regulation, transportation and environmental issues. He has chaired the Mayor's Transportation Advisory Committee in Boston (1985-86) and has been consultant to the governments of Singapore, Indonesia, Guatemala, Bolivia, Chile, Argentina, Spain and other countries. He is a member of the American Economic Association, the American Planning Association, and the Transportation Research Forum.

Ph.D., Public	Harvard University (1975)
M.A., Public Policy	Harvard University (1972)
A.B., Government	Harvard University (1970)

Joseph P. Kalt

Joseph P. Kalt is the Ford Foundation Professor of International Political Economy and chair of the Economics and Quantitative Methods Cluster at the John F. Kennedy School of Government at Harvard University. Professor Kalt is a specialist in the economics of antitrust and regulation, with particular emphasis on the natural resource and transportation sectors. His publications in the area include: *The Economics and Politics of Oil Price Regulation*; *Drawing the Line on Natural Gas Regulation* (with Frank C. Schuler); *Petroleum Price Regulation: Should We Decontrol?* (with Kenneth Arrow); and *New Horizons in Natural Gas Deregulation* (with Jerome Ellig). Professor Kalt has testified frequently before the U.S. Congress, federal and state regulatory commissions, and in state and federal legal proceedings on matters of competition policy, mergers, and industry regulation.

Professor Kalt is also co-director with Stephen Cornell and Manley Begay of The Harvard Project on American Indian Economic Development and the National Executive Education Program for Native American Leadership. In addition, he is the co-editor with Stephen Cornell of *What Can Tribes Do? Strategies and Institutions in American Indian Economic Development.* Since 1987, the Harvard Project has worked for and with tribes and tribal organizations, providing research, advisory services, and education on issues of nation-building in Indian Country.

Professor Kalt has served as the Kennedy School's Academic Dean for Research, chair of degree programs, and chair of Ph.D. programs. He is also a member of the Board of Trustees of the Fort Apache Heritage Foundation of the White Mountain Apache Tribe (Arizona), the Board of Trustees of the Foundation for American Communications, and the Faculty Advisory Board of the Harvard University Native American Program. He served as advisor to the Royal Commission on Aboriginal Peoples, a commissioner on the President's Commission on Aviation Safety, and on the Steering Committee of the National Park Service's *National Parks for the 21st Century.*

Ph.D., Economics	University of California at Los Angeles (1980)
M.A., Economics	University of California at Los Angeles (1977)
B.A., Economics	Stanford University (1973)

Figure 1

U.S. LOCATIONS WITH FREIGHT STATIONS BY NUMBER OF INDEPENDENT RAIL CARRIERS: FSAC ANALYSIS

	1994		2000	
Number of Carriers	Number of Locations	Percent of Total	Number of Locations	Percent of Total
1	22,492	82.4%	18,742	74.0%
2	3,726	13.7%	4,837	19.1%
3	731	2.7%	1,253	4.9%
4 or more	334	1.2%	508	2.0%
Total	27,283	100%	25,340	100%

Sources: Freight Station Accounting Codes; FTI/Klick, Kent, and Allen, Inc.

Figure 2

U.S. LOCATIONS RECEIVING RAIL SERVICE BY NUMBER OF INDEPENDENT RAIL CARRIERS: WAYBILL ANALYSIS

	1988		1994		1999[1]	
No. of Carriers	No. of Locations	Percent of Total	No. of Locations	Percent of Total	No. of Locations	Percent of Total
1	9883	90.3%	8556	88.9%	8397	86.9%
2	856	7.8%	858	8.9%	1072	11.1%
3	142	1.3%	144	1.5%	133	1.4%
4 or more	58	0.5%	71	0.7%	58	0.6%
Total	10,939	100%	9,629	100%	9,660	100%

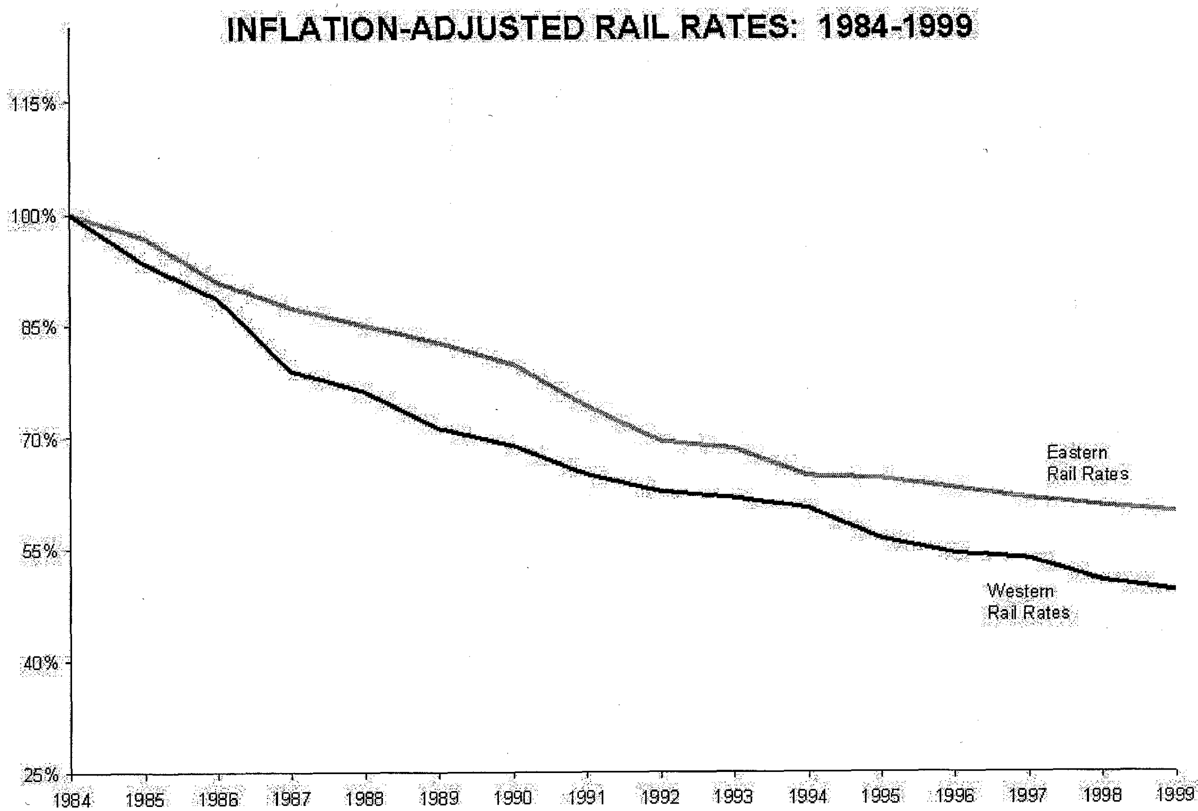
[1] In order to be conservative, we deleted virtually all Conrail observations in 1999 to prevent counting a SPLC as receiving service from two carriers if it was served by CR before the transaction and by only Norfolk Southern or CSX thereafter. Again, to be conservative, we retained Conrail movements for 202 SPLCs that were solely served by Conrail.

Note: Number of carriers includes both Class I and shortline railroads interlining with other Class I railroads or providing single-line service.
Location is defined as 6-digit SPLC.

Sources: 1988, 1994, and 1999 Waybill Sample

Figure 3

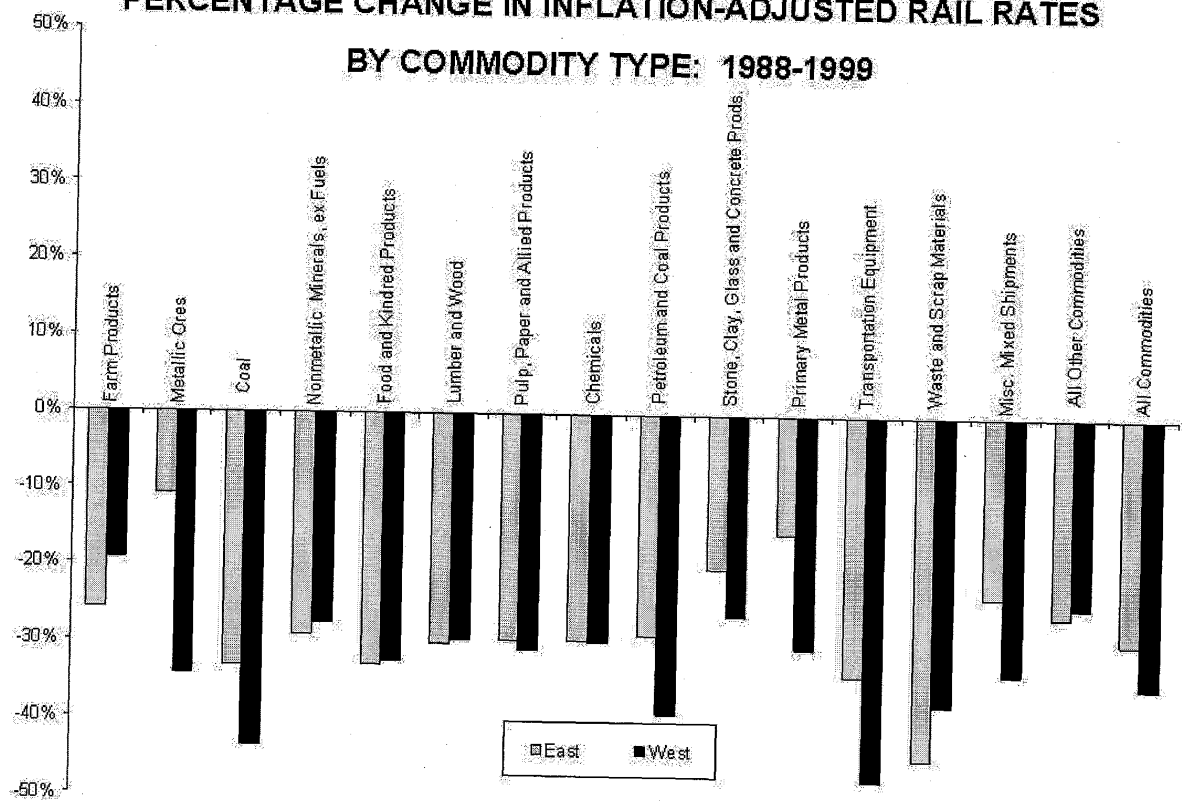
INFLATION-ADJUSTED RAIL RATES: 1984-1999



Source: Surface Transportation Board No. 00-52

Figure 4

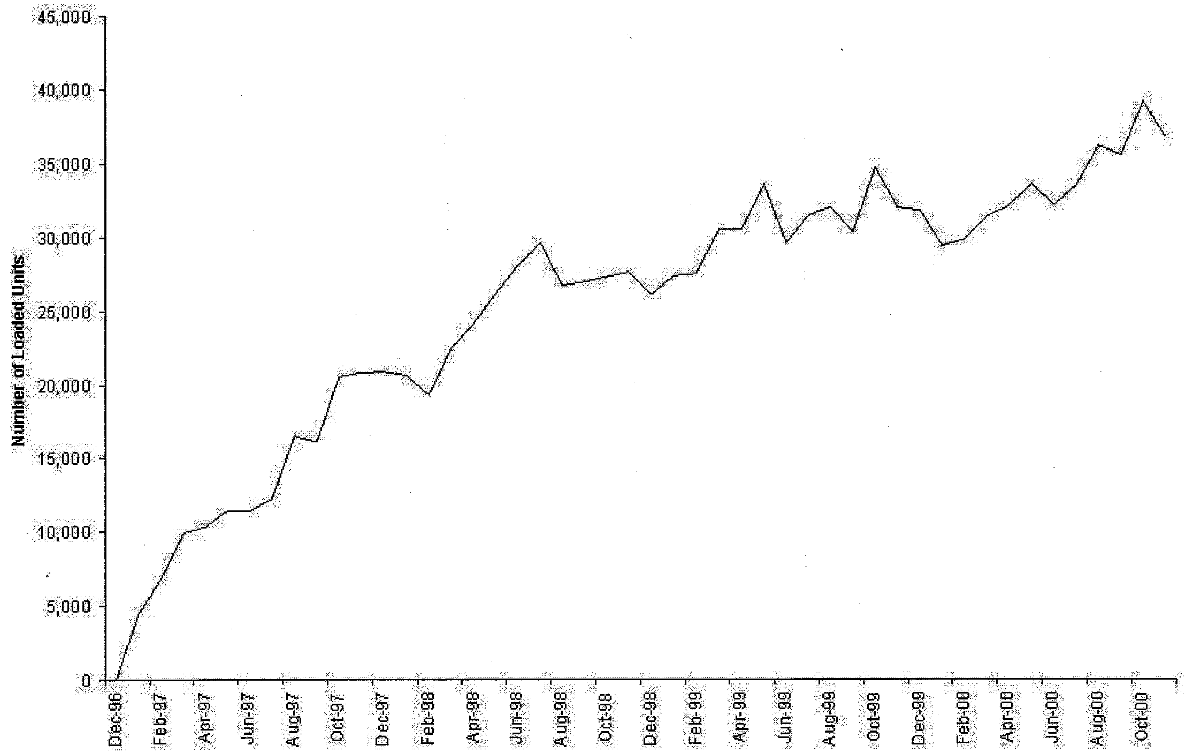
PERCENTAGE CHANGE IN INFLATION-ADJUSTED RAIL RATES BY COMMODITY TYPE: 1988-1999



Source: Surface Transportation Board No. 00-52

Figure 5

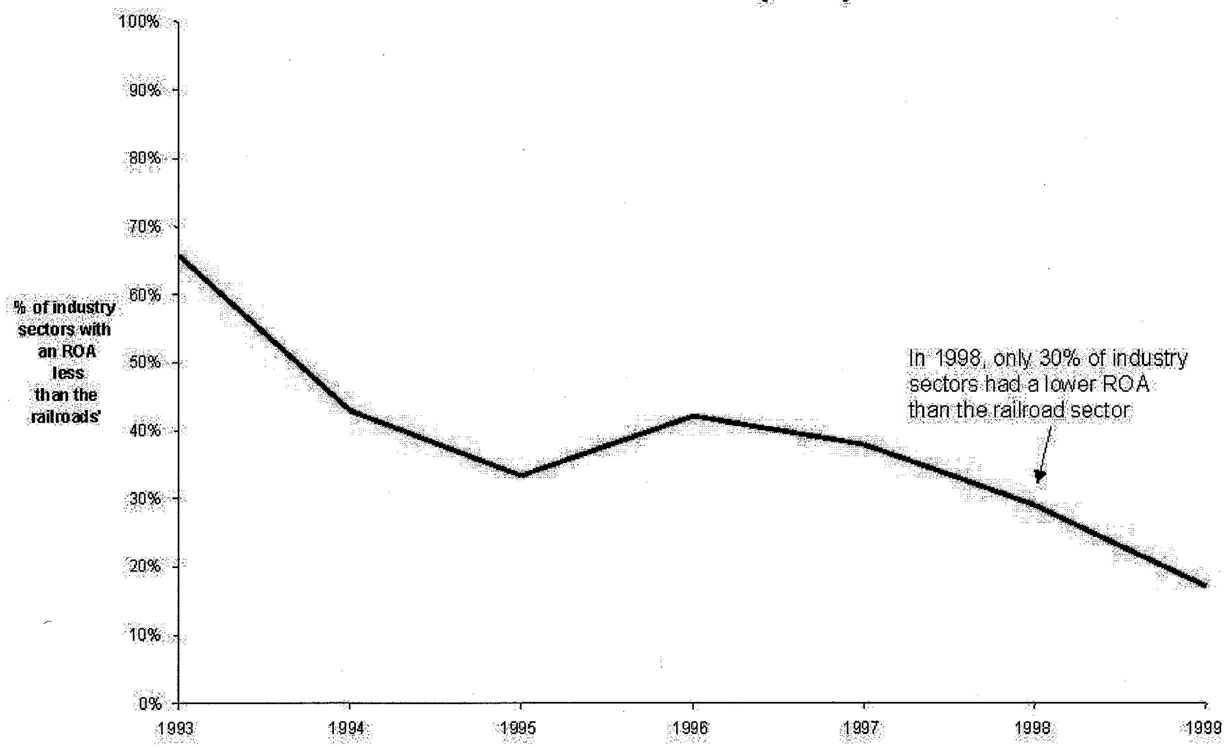
NUMBER OF BNSF LOADED UNITS ON UP/SP MERGER-CONDITIONED LINES



Source: BNSF Quarterly Progress Report in the Union Pacific and Southern Pacific General Oversight, January 2, 2001, Finance Docket 32760, Attachment 1.

Figure 6

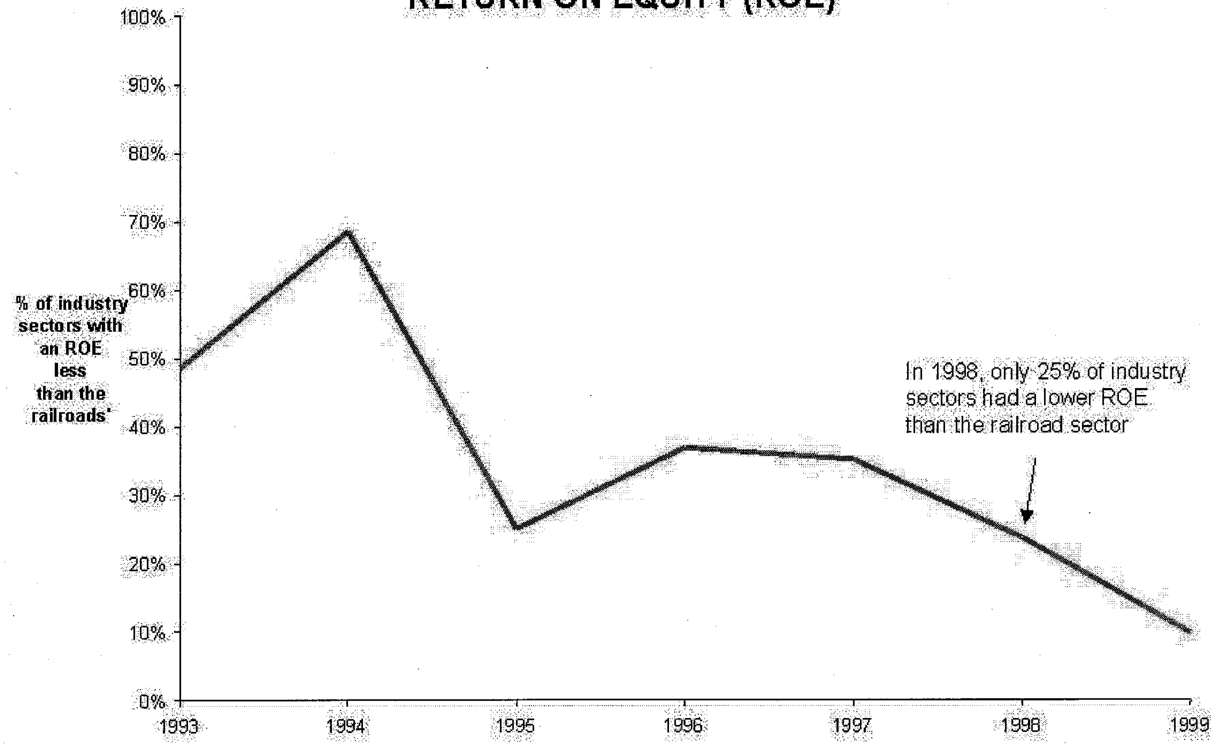
RAILROAD FINANCIAL PERFORMANCE COMPARED WITH OTHER SECTORS: RETURN ON ASSETS (ROA)



Source: Median returns for industry group; *Fortune*, April issue, various years.

Figure 7

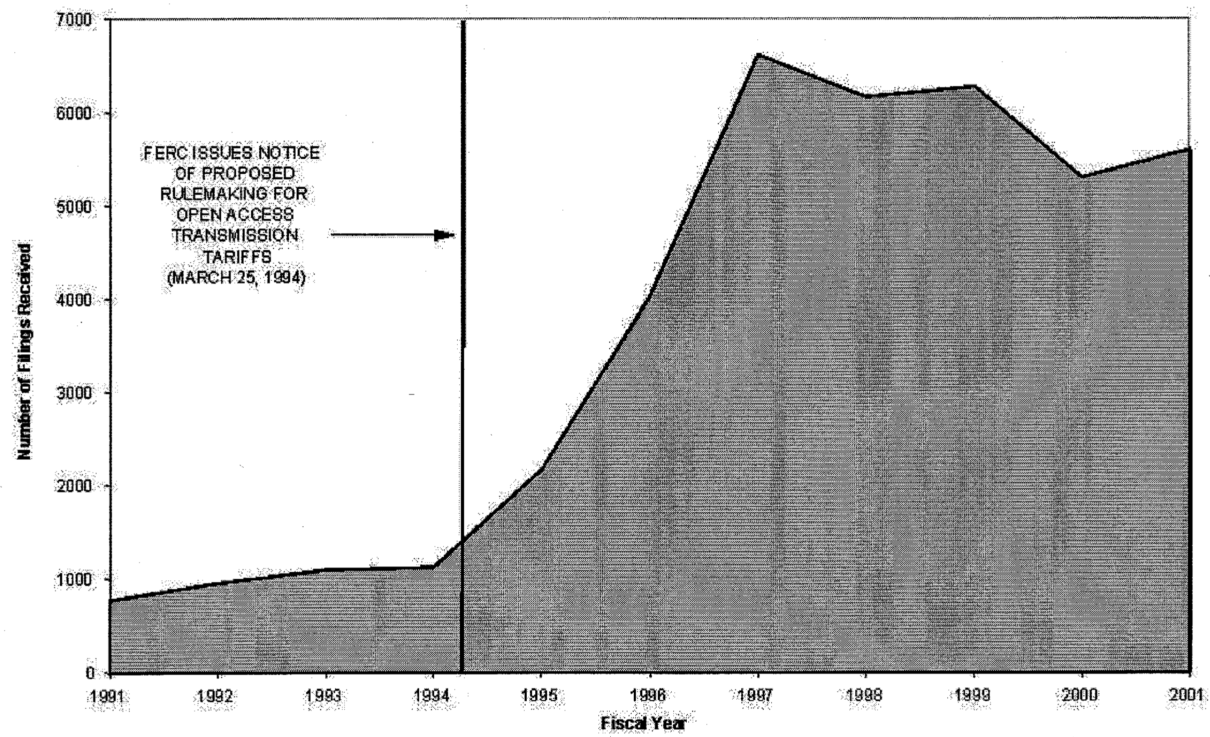
RAILROAD FINANCIAL PERFORMANCE COMPARED WITH OTHER SECTORS: RETURN ON EQUITY (ROE)



Source: Median returns for industry group; *Fortune*, April issue, various years.

Figure 8

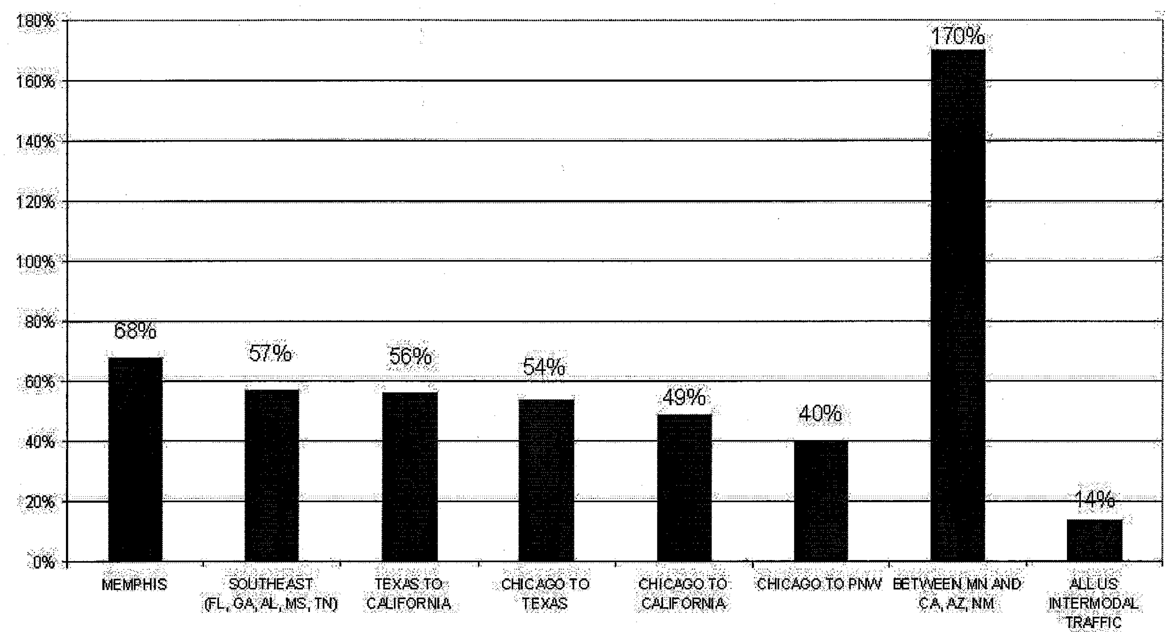
FERC ELECTRIC POWER DIVISION WORKLOAD: NUMBER OF RATE AND COMPLIANCE FILINGS RECEIVED, 1991-2001



Source: Congressional Budget Requests, 1993 - 2001 (2001 data based on FERC projection)

Figure 9

INCREASES IN BNSF INTERMODAL TRAFFIC ON SELECTED ROUTES, 1995-1999



Sources: BNSF Quarterly Progress Report in Union Pacific and Southern Pacific General Oversight, January 18, 2000, Finance Docket No. 32760, at 35; Association of American Railroads, *Railroad Facts*, 1999, at 26.

Figure 10

INTERLINE MOVEMENTS THAT WOULD BE "END-TO-END":

PRO FORMA ANALYSIS OF HYPOTHETICAL TRANSCONTINENTAL[1] MERGERS

Alternative Hypothetical Mergers	Transcontinental Units Moved (June 1999 - December 1999)[2]	Percentage of Total Transcontinental Movements (June 1999 - December 1999)
BNSF-NS	84,448	13%
BNSF-CSX	77,080	12%
UP-NS	116,882	19%
UP-CSX	93,756	15%

[1] A Transcontinental movement is defined as one that crosses from one side of the Mississippi River to the other side, excluding those movements that originate or terminate in states that border the Mississippi. There were 626,604 transcontinental movements in June-December 1999. Movements of empty units are not included.

[2] The analysis was restricted to the post-Conrail transaction time period, June-December 1999.

Source: 1999 Waybill Sample

VERIFICATION

I, José Gómez-Ibáñez, verify under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed the 11th day of January, 2001.

José Gómez-Ibáñez

VERIFICATION

I, Joseph P. Kalt, verify under penalty of perjury that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed the 11th day of January, 2001.

Joseph P. Kalt

BEFORE THE SURFACE TRANSPORTATION BOARD

EX PARTE 582 (SUB-NO. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

VERIFIED STATEMENT OF RICHARD J. PIERCE, JR.

I am the same Richard J. Pierce, Jr. who submitted the Verified Statement that was filed with the Opening Comments of The Burlington Northern and Santa Fe Railway Company (BNSF) in this proceeding. The purpose of this statement is to respond to certain points made in the Reply Comments of Edison Electric Institute (EEI) and the accompanying Verified Statement of Edward H. Comer.

In my original statement, I urged the STB to adopt a merger policy analogous to the policy used by the Federal Energy Regulatory Commission (FERC). Mr. Comer states that he is providing additional information about the merger policy of the FERC because of his expressed concern that my description is misleading. I do not question the accuracy of the additional information Mr. Comer provides, but that information does not render my original statement misleading. The purposes of this statement are: (1) to identify the fundamental points I made in my original statement that Mr. Comer does not seem to question; and (2) to respond to some of the inferences that Mr. Comer and EEI attempt to draw based on their descriptions of FERC's merger policy.

In my original statement, I asserted that FERC's merger policy is much more narrowly tailored than the policy proposed by the STB, even though FERC is required to apply an extremely broad "public interest" standard similar to that used by the STB in evaluating proposed mergers. Like the Department of Justice (DOJ) and the Federal Trade Commission (FTC), FERC focuses almost exclusively on the potential anticompetitive effects of a proposed merger. FERC relies on the combination of market forces and the natural incentives of firm managers to ensure that most of the other potential effects of a proposed merger are adequately taken into account in the decisionmaking process that yields a proposed merger. I identified the many advantages of a merger policy of that type that induced the Attorney General's Advisory Committee to recommend that all agencies adopt a policy of that type.

Mr. Comer emphasizes two features of FERC's policy that I recognized and discussed, but that I do not consider to have the significance Mr. Comer suggests. FERC requires that all transmission owning utilities provide equal access to their transmission lines, and FERC requires all merger applicants to propose some type of ratepayer protection measure. I will discuss each of those features at greater length later in this statement. It is important to note, however, that Mr. Comer does not quarrel with my basic point that FERC's policy is much more narrowly tailored than the proposed STB policy. To illustrate this point, I will identify four factors that the STB proposes to consider in reviewing a proposed merger that FERC either never considers or considers only in highly unusual circumstances.

First, FERC has never engaged in post merger oversight of a merger except in the important but narrow context of ensuring compliance with any conditions FERC imposes on its approval of the merger in order to avoid anticompetitive effects, e.g., a condition that the firm divest particular assets. Nor has it ever approved a merger subject to a reserved power to impose unspecified additional conditions or to punish a firm for failing to achieve all of the expected benefits of a merger, depending on the results of a post merger oversight process. Indeed, I have never heard of any agency that has attempted to reserve a power to impose ex post conditions on a merger or to punish a firm if a merger fails to meet all of the expectations of the firm or of the agency. It is highly unlikely that any socially beneficial mergers would take place in such a legal environment. It is possible that the Board could provide some public benefits by engaging in some type of non-intrusive post merger oversight limited to specific merger-related effects on customers, but it should abandon its proposal to reserve the power to impose unspecified ex post conditions on mergers or to punish firms for failing to fulfill all of the firm's expectations or the agency's expectations of a merger.

Second, FERC has never required a merger applicant to engage in the impossibly speculative and intractable process of predicting the responses of competitors to a proposed merger and then analyzing the expected effects of those responses. Nor has it ever suggested that it might disapprove a proposed merger because of speculation that one or more competitors might respond to the merger by proposing other transactions that might have anticompetitive effects. If the Board decides to incorporate in its merger policy consideration of potential competitive responses to a merger, it should limit the scope of that consideration to a merger that the Board finds to be a nearly certain contemporaneous response to the proposed merger. It should not require a merger applicant to engage in the inherently speculative exercise of predicting other potential competitive responses or the intractable process of attempting to analyze those potential responses.

Third, FERC rarely requires a merger applicant to prove that a proposed merger will have social benefits. Like DOJ and the FTC, FERC assumes that the managers of a firm will not propose a merger unless they predict that it will have socially beneficial effects and that the managers are in a much better position than any agency to make such a prediction. As I pointed out in my original statement, that is a well supported assumption in all circumstances save one. It is not safe to assume that a proposed merger will have socially beneficial effects when it will place the firm in a position to exercise greater market power. That is why FERC, DOJ, and the FTC require a firm to prove the existence of demonstrable public benefits only in the highly unusual situation in which the agency concludes that a proposed merger would have unmitigateable anticompetitive effects so serious that the agency would be compelled to disapprove the merger in the absence of significant, demonstrable public benefits. The Board should adopt a similar approach.

Mr. Comer claims that the 117 day average time FERC requires to review a proposed merger is misleading because it includes some mergers that raise no serious concerns. Mr. Comer is correct that the average includes some cases of that type. It also includes, however, many other mergers in which the firms had many billions of dollars of assets and annual revenues and many that raised serious anticompetitive issues. Of course, the length and complexity of the merger review process is properly based on the number and complexity of the competitive issues raised by the proposed merger, rather than the size of the merger measured in assets or sales. The bottom line is clear. Like the DOJ and FTC policies, FERC's policy allows it to review mergers expeditiously.

FERC's ability to review proposed mergers effectively and efficiently is attributable to two characteristics of its policy. First, the policy is narrowly tailored to require consideration only of the potential anticompetitive effects of a proposed merger. FERC does not attempt the intractable task of considering myriad other factors and then attempting to balance each factor against the others. Its policy is based on the well-supported assumption that market forces, combined with the enlightened self interest of the firm's managers, will be sufficient to ensure that all factors except potential anticompetitive effects will be considered adequately in the process of deciding whether to propose a merger.

Second, FERC uses procedures to review proposed mergers that are far more efficient and effective than the procedures used by STB. On page 8 of its reply comments, EEI argues that STB merger review proceedings inevitably require a lot of time because "shippers need time to . . . conduct necessary discovery, submit comments and evidence after the completion of such discovery, . . . defend discovery, . . . and present oral argument before the Board." FERC uses none of those cumbersome and inefficient procedures when it conducts its initial review of a merger proposed by one of EEI's members, and this initial review has nearly always resulted in a decision on the merits, without discovery or formal hearing. I am confident that EEI would protest vigorously if FERC proposed to use full discovery and formal hearing procedures in all utility mergers and without first screening out those mergers that do not present serious competitive issues and therefore can be approved without full discovery or formal hearing. FERC generally does not allow third parties to engage in discovery or discovery-related submissions of evidence and arguments in merger review proceedings. Instead, it specifies in advance and in detail all of the information the applicant is required to submit and uses staff data requests to address any inadequacies it detects in the information submitted by the applicant.

Mr. Comer refers to convergence mergers as a class of mergers that FERC is able to review expeditiously because they do not raise serious anticompetitive concerns. Convergence mergers involve the proposed merger of a natural gas company and an electric company. I agree with Mr. Comer that convergence mergers do not raise serious anticompetitive concerns. I consulted on three convergence mergers and provided the market power analysis in two of the FERC proceedings to review proposed convergence mergers.

It should be noted, however, that convergence mergers have a close analog in the railroad context. End-to-end rail mergers are very similar to convergence mergers. Neither class of proposed mergers raises serious anticompetitive concerns because neither involves a proposal to merge firms that compete with each other. The STB should be able to review proposed end-to-end rail mergers as expeditiously as FERC is able to review proposed convergence mergers.

I will conclude by discussing the two features of FERC policy that Mr. Comer identifies as flaws in my attempt to reason by analogy from FERC's policy – the equal access requirement and the ratepayer protection requirement. As Mr. Comer acknowledges, FERC's requirement that every transmission owning utility provide third party access to its transmission lines is not part of FERC's current merger policy. FERC imposed that obligation on *all* utilities in a rule it issued in 1996. Mr. Comer is accurate when he states that FERC began to condition its approval of some proposed mergers on adoption of an equal access commitment two years before it imposed that requirement on all utilities.

It is important to understand, however, why FERC adopted an equal access condition as part of its merger policy in 1994 and then replaced that policy with a universal equal access requirement in 1996. I believe that FERC began to impose equal access conditions on mergers in 1994 for two reasons. First, as a technical matter, FERC stated that it was imposing that condition on several mergers because it concluded that each of those mergers would have created an undue increase in the merged firm's share of the wholesale electricity market in the absence of an equal access condition. The equal access condition responded to that otherwise unacceptable competitive effect of each merger by allowing other owners of generating plants access to the market that otherwise would become unduly concentrated as a result of the proposed merger. That is a common response to a proposed merger that would create a firm that would be able to exercise increased and unacceptable market power in an important market. An agency often imposes a mitigating condition of some type on a merger when the agency concludes that the merger would have unacceptable anticompetitive effects in the absence of a mitigating condition. The key point is that FERC justified its open access conditions on mergers as a response to merger-related changes in market concentration, not pre-existing concentration levels. This is consistent with the way that merger analysis is conducted in every industry that I know of, and the Board should not depart from that widespread and well-justified approach of acting only to preserve competition that otherwise would be lessened by a proposed merger.

Second, it is fair to infer that FERC had a second unstated reason for beginning to impose equal access conditions on many mergers in 1994. By 1994, FERC believed that imposition of a universal equal access requirement on all owners of transmission lines would improve the performance of the electricity market, but FERC lacked confidence that it had the legal authority to impose such a requirement. It began its attempt to impose such a requirement through the only means that it was confident it had the power to use – by imposing an equal access condition on each merger. FERC soon discovered, however, that this means of trying to make a revolutionary change in its methods of regulating the electricity market was both ineffective and counterproductive. It was ineffective because an equal access policy is effective only if it applies to all facilities to which access is required in order to render competition effective, not just to the facilities that are owned by firms that propose to merge. It was counterproductive because it deterred firms from proposing to enter into socially beneficial mergers. About the same time, FERC also decided that it did have the authority to impose a universal equal access requirement. I am confident that is why FERC eliminated the equal access condition as part of its merger policy and replaced it with a rule that imposed a universal equal access requirement.

Deciding whether to impose an equal access requirement on the participants in a market is serious business. It must be preceded by extensive, detailed analysis of the characteristics of the market at issue. An equal access requirement has the potential to improve the performance of a market only in specific highly unusual circumstances. As I stated in my original statement, I am skeptical that an equal access requirement would yield socially beneficial results in the rail market. I have not studied that question with the care required to express an opinion with confidence, however, so I will leave that issue to be addressed by people with greater expertise with respect to the rail market. I am confident, however, that the Board should not attempt to implement such a policy generally in the rail market through the exercise of its power to condition its approval of mergers. Any such effort would be ineffective and counterproductive for the same reasons that FERC's ill-fated and short-lived attempt to use merger conditions to effectuate such a major change in policy in the electricity market was ineffective and counterproductive.

Mr. Comer also refers to FERC's requirement that each merger applicant propose ratepayer protection measures and urges the Board to adopt an analogous requirement applicable to proposed rail mergers. I am skeptical that there are ratepayer protection measures available in the rail rate context that are even arguably analogous in form or rationale to the ratepayer protection measures that are proposed by FERC-regulated electric utilities.

As the cases cited by Mr. Comer illustrate, the measures proposed most frequently by electric utilities are a commitment not to file an application for a rate increase to seek recovery of an acquisition premium and a commitment to freeze base rates for a few years. Those two closely related commitments make sense in the context of electric utilities. They apply only to the rates charged by electric utilities to perform functions that remain subject to pervasive cost-of-service regulation in order to protect consumers from potential exercises of natural monopoly power. Exercises of natural monopoly power have three well known adverse effects – artificially high prices, artificially low output, and artificially high profits that have the effect of transferring wealth from consumers to producers. Richard J. Pierce, Jr. & Ernest Gellhorn, Regulated Industries 29-47 (4th ed. 1999).

As the Board well knows, rail rate regulation under the Staggers Act is dramatically different in rationale, scope, and methodology from the traditional public utility model that FERC applies to the natural monopoly functions performed by electric utilities. Congress enacted the Staggers Act to respond to the serious problem of railroad revenue inadequacy, and the Board makes an annual finding that railroad revenues remain inadequate. That is the opposite of the problem that FERC attempts to address by applying pervasive cost-of-service regulation to the natural monopoly functions performed by electric utilities.

Most rail rates are not regulated at all because of Congress's well-supported belief that regulation of rail rates would be both unnecessary and counterproductive. The Board is authorized to regulate rail rates only when shippers establish the existence of market dominance.

Even in that situation, the Board never uses cost-of-service regulation. Rather, it sets a price ceiling based on application of Ramsey pricing principles. That method of ratemaking yields rate ceilings higher than cost-of-service regulation in order to allow railroads an opportunity to recover enough of their common and fixed costs to have a chance of earning adequate total revenues. As the Board's annual finding of railroad revenue inadequacy demonstrates, the Staggers Act methodology still has not produced the results Congress sought – adequate railroad revenues. In short, Mr. Comer seems to be urging adoption of temporary rate freezes that are based on the need to keep utilities from earning excess revenues in the context of railroads whose rates are largely unregulated because their revenues are inadequate. That analogy does not work for me.

VERIFICATION

I, Richard J. Pierce, Jr., verify under penalty of perjury under the laws of the United States that the foregoing is true and correct. Further, I certify that I am qualified and authorized to file this Verified Statement.

Executed on January 11, 2001

Richard J. Pierce, Jr.